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ROUNDTABLE HEARING ON THE HOUSING OPPORTUNITY PARTNERSHIP [HOP] AND HOME CORPORATION PROVISIONS

HEARING

BEFORE THE

SUBCOMMITTEE ON
HOUSING AND URBAN AFFAIRS

OF THE

COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

FIRST SESSION

ON

S. 566

TO AUTHORIZE A NEW CORPORATION TO SUPPORT STATE AND LOCAL STRATEGIES FOR ACHIEVING MORE AFFORDABLE HOUSING; TO INCREASE HOMEOWNERSHIP; AND FOR OTHER PURPOSES

THE NATIONAL AFFORDABLE HOUSING ACT

JUNE 7, 1989

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THE HOUSING OPPORTUNITY PARTNERSHIP (HOP) AND HOME CORPORATION PROVISIONS

WEDNESDAY, JUNE 7, 1989

U.S. Senate,
Committee on Banking, Housing, and Urban Affairs,
Subcommittee on Housing and Urban Affairs,
Washington, DC.

The subcommittee met at 9:45 a.m., in room SD-562 of the Dirksen Senate Office Building, Senator Alan Cranston (chairman of the subcommittee) presiding.

Present: Senators Cranston, D'Amato, and Pressler.

OPENING STATEMENT OF SENATOR CRANSTON

Senator **Cranston**. This session of the Housing Subcommittee will please come to order.

I welcome all of you this morning, as we continue the Housing Subcommittee's hearings on the National Affordable Housing Act.

This morning's roundtable discussion is especially important. It considers proposals that are at the very heart of the bill. I am pleased that we are joined today by so many outstanding individuals who have distinguished themselves in housing and will be the leaders in the effort to provide decent and affordable housing for all Americans.

I am convinced that we have a rare opportunity—probably the best since the 1940's—to shape a fresh, effective national housing policy. Housing is fast rising back to the place it deserves in the nation's priorities. I sense that the Nation is stepping up to a new challenge to expand the supply of affordable housing. Bold legislation is needed. It is important that we do it right. I think we are on the right track.

A key insight of the subcommittee's 2-year review of the Nation's housing needs is that the vital legacy of past housing policy is not the programs that were enacted down through the years, but the institutions that were produced by past housing policy. Institutions that have a clear public purpose can mature and innovate and adapt to fast-changing circumstances.

I see this demonstrated in institutions such as the secondary mortgage market entities, State and local housing finance agencies, and community affairs agencies, public housing authorities, and housing institutions in the private sector, both non-profit and for-profit organizations.

Building on this lesson, the National Affordable Housing Act will strengthen a nationwide network of institutions, partnerships of

State and local governments and the private sector dedicated to improving the Nation's housing. The bill will establish the HOME Corporation, a national institutions with a clear vision to support State and local housing strategies, and a powerful incentive to innovate.

The HOME Corporation will be a one-stop agency providing States and local governments with the various forms of Federal assistance that are needed to produce affordable housing. The HOME Corporation will provide very flexible capital subsidies. The HOME Corporation will provide credit enhancement through guarantees on mortgage pools backed by mortgages on affordable housing. The HOME Corporation will also provide technical assistance through existing organizations to expand the capacity to develop affordable housing, particularly in areas where that capacity is weak.

States and localities will not be given responsibility for housing and then be left to wrestle with three or four different Federal bureaucracies, none of which has a strong incentive or capacity to help you succeed. The HOME Corporation will establish a long-term partnership with States and localities.

Capital subsidies will be distributed partly by formula, and partly by incentive allocation. For each participating State and local government, the HOME Corporation will create a housing investment trust fund. A State or locality will be able to draw funds from its trust fund to be used very flexibly. Any repayment of these funds would go back to the jurisdiction's own trust fund for reuse as investment in affordable housing.

Half of the funds would be distributed among the States, with each State receiving at least $3 million. The other half would be distributed among larger local governments. States would have responsibility for addressing housing needs in all areas of the State, and cooperation between States and localities will be strongly encouraged.

The HOME Corporation will develop a shelf of model programs. A variety of model programs will be needed, because of the variety of housing objectives and conditions in different regions of the country. Participating States and localities will be free to adopt those model programs, to adapt them to their own circumstances to create their own programs, and to suggest additional model programs for the HOME Corporation.

The design of housing programs will become an ongoing national process of innovation and refinement. No longer will rigidities in federal legislation or regulation make a housing program unworkable at the local level. Ongoing active refinement and promotion of a shelf of model programs will enable the most effective methods to be adopted more quickly throughout the country.

For many reasons, I see the HOME Corporation as the keystone element of the National Affordable Housing Act. Developing and refining this portion of the draft legislation, as we are doing this morning, is very important.

The subcommittee is working to bring the National Affordable Housing Act to the Banking Committee for mark-up before the August recess. I ask each of you to give us your best counsel, so that we can come forth with the first-rate piece of housing legislation that the country needs and deserves. Then, we all need to begin working to achieve enactment.

I look forward to the roundtable discussion. And so, let's turn to the first issue. Each of you around the table this morning have had a significant impact on the National Affordable Housing Act through the extremely helpful comments, criticisms, and suggestions that you have made throughout the early stages of the bill's development.

Now that the Senate moves into the final refinement of this legislation, your candid observations and suggestions are really more important than ever to us.

I would like to start this morning by having each of our witnesses identify two key elements of the bill, one element you believe will strengthen the national effort to provide decent, affordable housing, and one element that you believe should be refined as we prepare for committee action.

Since we can return to those items for full discussion in the course of our time together, I ask you to be brief. Please, if you disagree with the comments that are being made, speak up. The most useful and informative way for this roundtable session to operate is if I get a difference of opinion expressed, so that we can sort that out and make our judgments as to how best to proceed. So a brief discussion back-and-forth is the reason for this format today, instead of the formal hearing that we normally follow.

May I start with Brian Hays?

BRIAN HAYS

Mr. HAYS. Brian Hays, chairman of the Public Securities Association, with Drexel Burnham in New York.

It occurs to me that maybe one of the most important keys in the proposed legislation is the discussion of the quality of underwriting standards, and I would like to get involved more in this as we go along. But I think it is going to be critical to the success of the program.

I think where some more detail might be helpful is in discussion of the vehicles, or vehicle that would be most effective from a cost viewpoint, and from production of the greatest number of affordable housing units viewpoint, as far as secondary market vehicles and structures are concerned.

Senator CRANSTON. If you want to comment, or object, or differ, or disagree, go ahead. Yes?

WARREN LASKO

Mr. LASKO. My name is Warren Lasko, with the Mortgage Bankers Association of America.

To address your question, Senator, I think something that leaps out at us, that is highly attractive in the HOME Corporation concept, is the one-stop service. The ability of a State or locality, or through them a developer, to come in and make things happen fast without a lot of bureaucracy is extremely appealing.

You asked for any reservations we have, or questions, I think ours would go toward the use of Ginnie Mae as a model for how the HOME Corporation would deal with guarantees and debt. We certainly want you to know, we think it is workable, and that it is a very positive step. We think it needs a lot of care in how you construct the organization, and that to the extent you use Ginnie Mae as a model you may not get the full benefit of the HOME Corporation's potential.

Ginnie Mae is a very small, process-oriented organization that basically processes paper and takes no risk, or at least minimizes risk. The HOME Corporation, as we see it, is one that is going to be very creative, but it is also going to have to be able to make judgments and decisions as to whether the process is reliable, and that does involve some risk-taking and some judgment, and requires quite a different type of staff and organization than the Ginnie Mae model.

JOEL RUBENZAHL

Mr. RUBENZAHL. My name is Joel Rubenzahl, director of Community Economics, which is a nonprofit, technical assistance organization based in Oakland, CA.

One of the major advantages that I see in the bill as it is now drafted is that localities and developers can get the money without major strings attached, other than having an approved plan.

Having dealt with FHA many times, and HUD in a variety of ways, in dealing with programs, it is refreshing to think that local government and State government and developers can put together a program of development, and actually go in to get the money and do the development; rather than spending, unfortunately, long periods of time dealing with major volumes of regulations, which unfortunately make it more difficult to develop the housing that we are trying to see built.

One major concern that I have with the bill as it is now structured is in the targeting requirements. Unfortunately, we have a gigantic homeless population, and people in this country who cannot afford the kinds of rents that this bill as it is now drafted would require, or would allow.

I would propose that we have a much stronger targeting requirement. Something like 50 percent of the units would have to serve people below 35 percent of median income, with adjustments for family size and based on the locality; and 25 percent of the units would have to serve people below 50 percent of median. An additional 25 percent would have to serve people below 80 percent of median.

I believe that would be sufficient to allow a homeownership program to develop, as well as rental programs, that would truly serve the people who would have the greatest need.

Senator CRANSTON. How would you finance that?

Mr. RUBENZAHL. I think what it really comes down to, Senator, is that you have to put the money where the need is. You cannot do it without money. And I, personally, am in favor of spending more money on a relatively smaller number of units that serve the people with the greatest need, and spending less money to serve more people who have more of an opportunity in the marketplace.

In my market area, northern California, people at 80 percent of median income are basically market renters, they can afford market rents. And it seems to me inappropriate for the Government to put money into serving people who can compete in the marketplace.

Senator CRANSTON. I appreciate your coming all the way from California.

Yes?

ED SCHWARTZ

Mr. SCHWARTZ. I am Ed Schwartz from Philadelphia, where I am the director of the Office of Housing and Community Development.

I guess the HOME Corporation is the main feature of this act that would benefit us. There are other things here that would, but as I look at it as an administrator and say, "Well, what do I get to do differently with this bill?" the HOME Corporation stands out.

I certainly share the previous comments about the desirability of one-stop shopping, not having to wind through endless hours of regulations and challenges over the rebuttals and rejoinders, which account for about a third of my time.

I would add to that, in terms of our needs in Philadelphia, where we have an old housing stock needing rehabilitation, surrounded by people who cannot afford the supply of available housing—95,000 people in Philadelphia can afford no more than $125 a month for housing, and there are only 5,000 rental units in our city at that price. And at the same time, we have upwards of 15,000 to 20,000 boarded-up and vacant houses that require over $50,000 for rehabilitation.

The HOME Corporation's main advantage would be in providing this investment fund to narrow the gap between the cost of rehabilitation and what a person can afford, either as a home owner or a renter, to pay back. When projects under existing regulations cannot be done, it is because that deep subsidy pool is not available.

The main concern that I have about the act concerns the balance of resources between States and localities, fixing it quite like this. Frankly, with the relationship between our city and the Commonwealth of Pennsylvania, under both parties is not good. That is an understatement. And in this field, the role of the State and the housing of this kind has been negligible, a point of major debate right now that I have raised.

So that I would like to see, if we stuck with this formula, 50-50, that there be some requirements in State use that, if not met, would trigger reallocation of funds by the Federal Government to major localities. That may be a compromise between changing the formula as you have designed it, given the States' desire to do this, and then keeping it there. Because I am aware of a significant amount of unspent and unused community development money in the State housing office that could be used by our city and others if there were some requirement at this time.

MARVIN MARKUS

Mr. **Markus**. My name is Marvin Markus, managing director of Kidder, Peabody and Company, which is a Wall Street investment banking firm.

Previously, about 10 years ago, I also served as deputy housing commissioner of New York City, so I think some of the perspective I bring involves that.

Let me say that I think the HOME Corporation is a fitting successor to many of the programs that have existed throughout the years, going back to 1937 and the United States Housing Act, and it deals with, basically, the two basic public policy thrusts that the U.S. Government has generally dealt with; that is, raising effective demand for the lower-income households, and mortgage market intervention. Traditionally, those two functions have been separated in different programs.

If I could take those two functions separately and attempt to address your question, the first question about raising effective demand, I think the real advantage of the HOME Corporation, as I see it, is the flexibility that is built into it to be able to serve specific State and local needs through the line of credits, where you can create a program targeted to the specific needs.

The second part, which is the mortgage market intervention, which has historically been exemplified by the role of Fannie Mae, Ginnie Mae, Freddie Mac, what have you, I think is perhaps the weakest part of the legislation, at least in my mind, and perhaps the most confused. Which is the real relationship of those entities which have had market access and have had good, well-established underwriting criteria, to this new corporation, and the interface between the two, volume accessibility at the right price?

Because what all of these efforts have done is made mortgage interest rates affordable, but not affordable enough for most low-income households. That has been the role of the effective demand portion of the housing policy.

So, I think those two issues need to be dealt with somewhat separately, and then pulled back together in the HOME Corporation, efficiently.

Senator **Cranston**. Thank you very much. We have gone one-third of the way around the table. I thank each of you for being so brief and so direct.

I do want to say, I have not heard from anybody else yet. Do any of you differ with anything that has been said up until now? Anybody around the table? Do any of you want to stress agreement with anything?

Yes, over here. I am trying to get a discussion going.

TERRY DUVERNAY

Mr. **Duvernay**. I understand. I hope I can add to that. My name is Terry Duvernay, executive director of the Michigan State Housing Development Authority.

What I would like to do is to differ a little bit with my friend, Ed Schwartz, understanding the concern, the traditional concern, of the relationship between States and their local governments, and the ability of States to work with those governments to provide for things like housing opportunities.

I would say that the history of the past several years, 20 years, has been one where that started a reversal. I think, if you look at the creativity and innovative programs that many State housing finance agencies have brought to bear in this period, when HUD has not been as active a player as they should be, that role would be enhanced by something like the HOME Corporation, particularly its modeling aspects. If you go through a list of many of these innovations, they take into account the views of local government.

In our own experience in Michigan, working with the cities of Detroit and Grand Rapids, we have been able with State resources to allow local resources—be they community development or locally generated resources—to go further.

I think we have an opportunity with the HOME corporation to make that happen. So I would support the HOME Corporation, particularly the modeling aspect, as a way to bring resources to bear, in addition to the resources that the states bring to that job.

Senator CRANSTON. Yes?

JOHN SIDOR

Mr. SIDOR. Senator, my name is John Sidor, with the Council of State Community Affairs Agencies, replacing Amy Anthony, who is on a plane at the Boston airport and cannot get here.

I just wanted to follow up something that Terry said, and give you a very specific example. I had the pleasure this Sunday and Monday to be at a retreat of Governor Celeste's housing commission in the State of Ohio. Here is a State that, to this day, has not a strong housing presence, Senator. But your bill has energized that entire State.

That commission of private sector, public, State and local, nonprofit representatives is talking about setting a target of $500 million over the next 5 years of State money, of passing a constitutional amendment, of reorganizing the State government, of developing State and local-private sector partnerships.

Indeed, I think in this year you will see the legislature pass $20 million as a start toward that, of State monies for housing. So I think the kind of bill that you have crafted, this partnership in flexibility, is energizing States and local governments across the country.

I really do think we will see an entirely new set of actors very forcefully in a very short time after this bill is signed by the President.

Senator CRANSTON. That is fantastic. It is the best news we have received in a long time.

Yes?

WALTER WEBDALE

Mr. WEBDALE. I am Walter Webdale, president of the Association of Local Housing Finance Agencies.

I tend to disagree with the people at the State level. Over the last 8 years, when we have had this terrific slump in the production of affordable housing assistance from the Federal Government, we at the local level have not necessarily found much support from the State financially.

I think at the local level, you are going to find a lot of expertise was built at the local level to finance housing, to build housing, and to bring a lot of local resources to it. I think, when you look around the United States at the various States, we do not find many States that have been in that arena where they have general fund money that they have put forward for assisted housing.

I know in my own State of Virginia, it is just recently that the State began to appropriate money for housing, even though we have had a housing finance agency for years. The county of Fairfax, where I am the director of Housing and Community Development, has out-spent the State year after year in the amount of general fund money, and also in building expertise that is paid for locally for a housing product.

The State itself is spending over the next 2 years about $20 million of general fund money, and that approximates what Fairfax, Virginia spends annually in affordable housing. I think we have got to look to the localities to continue. The major thrust has been there, the expertise is there, and with some help of long term financing from the State if we are going to meet the local needs, we should have the lion's share of the money.

Senator CRANSTON. May I ask your advice? To follow up on what Mr. Sidor said, yesterday we had some conflicting advice. The Governors liked the 50-50 split on these funds allocated to localities. Some of the mayors would like to see a 70-30 split.

What is your feeling about that? What do you think is best? At 50-50?

Mr. DUVERNAY. From a purely State point of view, I would argue for more of the resources on the State side of the split; but I am not going to defend that case, because I think it is a well thought-out position that the bill presents—a 50-50 split between States and localities.

What I think we have learned over the past several years is, we cannot do it alone. I do not think the States can do it alone, I do not think local governments can do it alone, and I do not think we can do without the Federal Government. And so this bill starts to bring the Federal Government back into it.

But building on what John said, it is a partnership that is engendered through these types of efforts. I would agree that a 50-50 split between States and local governments is workable. I could argue for more on the State side, based on the experience of the past several years where new programs have been created not only that are State programs, but where a State program exists they exist in local government entities or within broader geographical areas.

The question is, do they operate in concert with local governments? And I think the strategy requirement allows for local governments or State governments to make sure that the resources are available and are directed toward the need.

I think what ought to be stressed is the need to cooperate between both State governments and local governments. I think the States are ready to do that.

Senator **Cranston**. Some people were trying to get in on the earlier discussion.

Barry?

BARRY ZIGAS

Mr. **Zigas**. Senator, I am Barry Zigas, president of the National Low Income Housing Coalition.

I appreciate the opportunity to join you today. I wanted to comment both on this conversation and make a comment on an earlier one. I think the people we represent, the nonprofit organizations, housing advocates, and consumer organizations—the by-play between State and local governments is one that concerns those entities very greatly.

Because I think what you are hearing is, there is no uniformly spread capacity throughout the country among State and local governments, and some local governments, and some State governments are very strong. Some are very weak. Given that, these consumers that we represent are willing to go with this model of decentralization, in fact, it was featured in the legislation we had drafted, and promoted it as a way of leading to more decisionmaking at the local level.

But it leads to a conclusion about the Federal Government's responsibility in fostering that relationship. And that comes down to the Federal Government being very, very clear, very narrow, and very intensely focused upon products it wants its money to create at the State and local level.

That leads me back to the issue Joel raised about targeting. We agree with the initiative and the obvious movement that has taken place from both sides of the aisle here but we remain very concerned about the targeting in the bill. As I am sure you know, we have recently completed a study on the needs of the poverty-level households.

There are over 3 million poverty-level rentals, whose median income is less than $5,000, who pay almost three-quarters of their income for rent and utilities. They will not be reached by targeting 80 percent, or even 50 percent of the area median, especially when we hear the sort of differing opinions about both the level of expertise and the level of commitment at the State and local level for operating in these program areas.

It is much more important for the Federal Government to narrowly focus what it wants its money to do. I would very strongly urge that the targeting requirements in here be reconsidered. I think Joel's proposal is one worth considering.

The other area has to do with permanent affordability. You have been diligent in the rental housing provisions, in requiring some form of, I suppose, rent regulatory agreements, and the imposition of long-term restrictions. But in the homeownership sections, which for many families may offer the best form of housing assistance—even very low-income families because it is so much more appropriate to families and communities—we have no long-term restrictions, except that the housing be made available to people at 100 percent of median on resale.

I would suggest that the committee consider ways of imposing limited equity appreciation provisions in this housing area—this is housing subsidized at the local level with money for homeownership—and that it be required to be maintained at a reduced appreciation in the market. Not only would it be sold with this form of subsidy down the road, but you know you are creating a supply of housing that will be available over a very long period of time for low-income use.

I think the more of these kinds of targets you impose upon State and local governments, the more focused and effective their intervention will be, because you will be very clear about what you want your money to produce.

I think, given the fact that, in the end, low-income consumers look to the Federal Government as the area of government most able to help meet their needs, that that is a responsibility.

COMMENTS BY SENATOR D'AMATO

Senator D'AMATO. Barry—if I might, Mr. Chairman—I think your suggestion, as it relates to targeting in the homeownership area, and placing some limitations, if I read you right, on the amount—would permit some appreciation, but the amount of the appreciation—I think that is an excellent idea.

In the village that I live in, we had a tremendous program, in which the village made available properties it had acquired over the years and some abandoned streets which they donated to write the costs down of the construction of housing, then using the 235 which reduced the interest rates. They were able to produce 40-some-odd homes at a very modest price. I think the range was between $45,000 and $57,000. They did this over a period of years.

The vast majority of the young people who bought those homes still live in them, 30 of the 42 or 43 families. But we did see a situation where a number of them sold the homes and made enormous windfalls. And so I think that that is a very important lesson that we should—and I mention it to the staff—attempt to teach, without taking away the homeownership and entrepreneurial spirit.

Certainly, they should be permitted to have a gain of some kind. But some of these people sold the homes for close to $200,000, after buying them for $50,000. That is the kind of appreciation, and of course write-down, that occurred during that period of time. In 7 years it just exploded. As a result, a lot of the villages' initial purchases for maybe $7,500 turned out to have a value of $50,000.

So we want to keep that housing stock available, and there should be some—but that is a very important point. I do not quite understand your point as it relates to the rent restrictions. That was another area in which I think that the use of targets and limitations so that there are not windfalls to those people, is important. Allowing any windfalls to go back into the housing program, might be another way of accomplishing that.

In other words, if over the course of years the property has appreciated, should some of that money go back into a housing program? Or, would you just artificially say that the value of this will never exceed "X" number of dollars?

Mr. ZIGAS. My own preference, Senator, would be that recapture would be better than no restriction or pay-back. But the goal here ought to be, with Federal subsidies, to create a supply of housing affordable to low-income people, moderate-income people, over a long period of time.

Senator D'AMATO. In other words, you would keep that property. It would be available at a particular level, and people would know that, if they were to buy this place, they would be limited as to the appreciation?

Mr. ZIGAS. Yes. Their equity would grow at a fixed rate, but not excessively.

Senator D'AMATO. And you would have some kind of a pool whereby people could, by way of lottery or what-not——

Mr. ZIGAS. Waiting lists, the same way you did it the first time around. There would be a pool of people eligible.

Senator D'AMATO. And you draw their names out by lottery, etcetera. I think a lot of communities are now using that, and you get off the business of who signed it first, et cetera.

Mr. ZIGAS. But you would make the housing available to the same target group. What you would do over time is, be creative. The creative pool of housing at the place where it is most efficient to provide it, for low- and moderate-income people; not to let the stock trickle down to them. That is much more efficient use of your money.

Senator CRANSTON. What limit would there be on the equities they acquired? They would only get the equity if they paid in that much money?

Mr. ZIGAS. Well, appreciate it by some fixed amount. I could ask Joel to give you some advice on his experience with the limited equity co-ops and some programs in California. But there have been models established. The owner equity appreciated by a fixed amount, plus any improvements that the owner puts in of course increases the basis.

Senator CRANSTON. There would be enough of a gain for them so they would have a sense of ownership.

Mr. ZIGAS. Of course. And the objective is not to cheat people out of some appreciation of their invested money; nor is it to cheat, in effect, the public good out of the value of the home, simply because of the rapid appreciation in the marketplace.

Senator CRANSTON. Can you express thoughts on this particular point?

ERIC EICHLER

Mr. EICHLER. I am Eric Eichler, chairman of the Linpro Co., a national real estate company that develops multifamily housing. I represent the National Multi Housing Council here today. It has many of the major players in the business as participants in that council.

One of the problems you are talking about—it is really a very interesting point—is really a question of supply. One of the reasons that the price of housing has gone up so dramatically in the last 15 years is because there has been an excess of demand over supply.

You can try to control that supply and direct it, as Barry suggested, which may work in some instances. But I think that is a complicated way of doing it. I would favor seeing a greater supply of housing coming into the marketplace.

I think if the supply is there, as we have witnessed in many areas of the country, the price of the housing will stabilize by itself, by the market and a good supply of housing, and of proper housing, brought on. With the right format and the right kind of financing, it will go a long way to help solving this problem that you are referring to, Barry.

Senator **CRANSTON**. How do we increase the supply?

Mr. **EICHLER**. You have to build more housing.

Senator **CRANSTON**. What do we do to stimulate that with this legislation, with the limited resources that the Government has available? There is not much money right now.

Mr. **EICHLER**. I think what the Government has to do, it has to leverage its capability so that it can be expanded into the marketplace. I do not think the Government can directly subsidize all of the housing that is necessary, an I think everyone knows that right now. But the program has to be innovative enough so that that capability can be leveraged to a greater supply of housing.

In order to do that, the cost of housing has to be not controlled, but has to be kept down, with good, simple construction codes, and non-bureaucratic practices.

Senator **CRANSTON**. Thank you.

LELAND BRENDSEL

Mr. **BRENDSEL**. Thank you, Senator, for inviting me here today. I would want to commend both senators and their staffs for, the excellent job I think they have done in really assessing the nation's housing needs and in proposing this legislation.

I think the development of the HOME Corporation shows foresight and forethought as to how to address some of these critical needs. An aspect I would like to focus on here—I can bring this back to, I think, part of this discussion here—is that an important part of the idea behind the HOME Corporation is really to build on what works.

We have a number of organizations—whether they are federally sponsored institutions like Freddie Mac and Fannie Mae, or State and local government organizations—that have well developed housing programs.

Freddie Mac, for example, has had extensive experience in multifamily, in apartment lending. We are the major, really, source of multifamily lending in New York City itself, for example. We have developed, really, a very active and effective secondary market for multifamily mortgages, working with local government organizations in some cases.

Overall, our experience has been that these are very good quality loans, and at the same time they have rentals that are probably 20 percent less than fair-market rents for localities. But nevertheless, there are situations where there are more difficult properties to lend on, where the credit enhancement mechanism that we have been talking about really is an important part of this feature.

By bringing together the federally sponsored corporations as well as State and local, with resources of the Government, is an important part, I think, to bringing more lending and more resources to address these critical housing needs.

Mr. **Webdale**. Senator, I would just like to go back to the subject of keeping the supply of housing. I thoroughly agree that, if we are going to bring someone to homeownership through governmental assistance, that we should make sure that the home is retained in the supply.

We in Fairfax County run such a program. When we do put money into a home, we then establish an appreciation formula, to make sure that that house remains affordable to lower-income families.

I think it is important to remember as you do it, though, that we still have to allow that family to earn enough equity so that if they do want to pick up and move on, that they can move up the ladder of homeownership. And second, that there is enough equity also there so that they get a sense of homeownership, and that they are not just a renter who has been put into a slot that looks like homeownership.

But it is important to keep that supply. With the amount of housing that we are losing these days that is affordable, I think it is well to start building more. If, in the future, we lose it, it would be a disaster.

Senator **Cranston**. Yes.

Mr. Dale.

LARRY DALE

Mr. **Dale**. I am Larry Dale, Fannie Mae's senior vice president for multifamily housing.

I would also like to thank you for having us here, and to commend you and your staff for leading housing back to the top of the Nation's agenda.

I would like to come to the defense, a little bit, of the bill, in terms of the delicate balance that it struck in responding to, if you will, the most pressing housing needs, and responding to those at other ends of the scale, including first-time home owners and some market-rate or low- and moderate-income, but not homeless, renters.

I think that is a very delicate balance. And it is important for the bill to address more than one spot in the housing continuum. We should have learned our lessons over the last several decades, that when we focus assistance in one area, what we tend to do is that maybe we solve that problem, but we tend to create another one. And I think this bill does a nice job of providing flexibility, so that State and local governments can respond to the needs that they identify and that are important in their areas, and under a fairly broad and flexible Federal mandate.

So I would like to come to the defense of the bill there. I think the suggestions on homeownership are good ones, and need to be explored in terms of a partial recapture of equity. But on balance, I think the bill does a nice job of trying to balance responding to different housing needs.

Senator **Cranston**. Thank you very much.

Mr. **Rubenzahl**. I would like to pick up once again on the issue of the BMR, below market rate units that Barry was talking about, and others. I want to let you know that not only in Fairfax County, but throughout portions of California there are already programs that do exactly what Barry has described, and in market areas.

Unfortunately, we have to work in market areas where median housing prices are well over $200,000. But what is happening in some of those localities is that they are bringing in people, nonprofits and for-profit developers, through local subsidy and State subsidy. They are bringing in units quite substantially below the market.

Where that is the case, there is a great demand for the homeownership, even though the restrictions are very severe, even though what the family is getting out of it is not an opportunity to move up to new housing, to new ownership housing, because they cannot afford it unless their income changes dramatically while they are in the below-market-rate housing.

What they are getting is ownership and control for as long as they live there. We have a fair amount of experience now which shows that there is great demand, if the price is right, and that residents and owners will take the restrictions along with the housing, in order to just have housing at all.

So I would very strongly support the notion that the units themselves remain affordable. It does not matter to the resident whether there is recapture or the unit itself remains affordable. So I would opt for the unit. I think that is a much more efficient way of preserving housing affordability over time.

Senator **D'Amato**. Do you get many appreciation problems?

Mr. **Rubenzahl**. There is the California law which defines limited equity cooperatives, which allows up to 10 percent simple interest on the downpayment, plus the amount of improvements made, not to exceed the cost. And it works.

Senator **Cranston**. Al, did you have a question on another area?

Senator **D'Amato**. Yes, Mr. Chairman. One of Senator Cranston's, I think, very strong positions was the HOME Corporation. I think he feels very strongly about attempting to provide that kind of resource to local communities, et cetera, in this housing area.

Over a period of time, some of the larger communities have developed some expertise in the larger cities. Some are in need. In addition—which I think is equally important, if not more important—there is the problem relating to the secondary mortgage market, that relates to the production of low-income, multifamily housing.

There are a number of people here who have expertise in this area. I would like to know, what you think we need to do in this legislation? Or, should there be additional legislation as it relates to this area? Or, is there great enough flexibility under the existing legislation to facilitate the growth of a secondary market for buying loans of low- and moderate-income housing, as it relates to the multifamily housing?

How do we help create it? What tools do you need, the private sector, to make this go? Because without this—I think one of the gentlemen, and I do not know if it was Mr. Webdale or the gentleman next to him, said that the only way we are going to get this to go is to leverage the dollars. That means the private sector dollars are going to make the housing bill go here. I believe that to be the case.

This has been a major stumbling block. So what do we do in this area? Mr. Lasko?

Mr. LASKO. I think I could give you a rather positive response. We read this bill again and again, and all the possibilities are not clear on the surface. But I think it is written in a broad enough way that you can mine it for possibilities.

Let me share one thought with you. Senator Cranston mentioned earlier, how do we use these scarce resources to develop supply? One thought feeds right into your suggestion that you could turn to financing in the secondary market. To pick one possibility—and there are many—take the homeownership area, and the possibility that you might want to reach down into the range of young families who cannot afford the first home. They are close.

Now, it does not deal with the most needy. But you could take your HOP funds—for instance, a locality could use a portion of its HOP funds to in effect buy down the price of a house, to in effect make the downpayment on the house, the substantial value of which could then be financed beyond that.

Once you get into their range of affordability, even though the local government has bought down the price, you can put a viable mortgage on that. And it is securitizable. That way, in effect, you have made a 20-percent downpayment through local funds, and financed the other 80 or 75 percent and you get 4-to-1 or 3-to-1 leverage on your Federal Government money, and assist four or five times as many families.

The thing we would urge in the secondary market arena is that the secondary market programs, whether they are Fannie Maes, Freddie Macs, or Ginnie Maes, work best when you have a reasonably standardized mortgage instrument with well recognized underwriting standards. The prepayment provisions, the terms, are all fairly well recognized.

So one thing we would urge there—and I think it is possible in the bill as written—is that the people who run these programs, the HOME Corporation, understand that you do not have to do a lot of tinkering with mortgage instruments, as we already know them, and that in fact things work better if we can use a homogeneous instrument that is well recognized, that is poolable, rateable, in large volumes, and market them.

Mr. Hays can address this better than I. The market, I think, will accept that, if it is recognizable and they can underwrite it. So I am trying to be positive, and say that there is room for leverage, and there is use in the secondary market for these purposes.

Senator D'AMATO. Mr. Hays, how do we get that secondary market developed to really give us a pool?

Mr. HAYS. One thing I forgot to say before is that I commend you on the format of these hearings. I hope it is going to be a model for the future, for a lot of other congressional testimony.

I think that it maybe satisfies the frustrations of a lot of people who might have appeared before you over the years.

Senator **D'Amato**. You mean the 3-minute witness and hurry up? [Laughter.]

Senator **Cranston**. I am glad you agree. It is much better when you can follow a train of thought and get conflicting views and so forth.

Mr. **Hays**. I have one general comment first, which is that I think it is important to resist the temptation to target a certain number of units, and then figure out the best way to get there.

Instead, I think what you need to do is to design a program that has integrity, that is going to last over the years, and let that program dictate the number of units you are going to be able to create in a particular year. That is an important factor for the secondary market, too, because it is a problem when a program looks good on the surface and 2, 3, or 4 years later, you have problems with the underlying mortgages.

There may or may not be a basic conflict. Because, on the one hand, I agree that you need a diversification of approaches to this problem; however, at the same time, in order to get the maximum efficiency and pricing in the secondary market, we have to have standardization.

You have already got a problem in this regard, in the sense that you have got a 50–50 or some other split between multifamily and single-family, and those are two entirely different animals in our marketplace. Ideally, but maybe not possibly, you should settle on a single multifamily form of mortgage, and a single single-family form of mortgage.

And, as I think Warren mentioned, standardization for things like servicing fees, maturities, and prepayment features—you have another division with the fact that you are going to have a variety of coupons as different interest rates change. That is a move away from diversification. Ideally—although I do not know if this is practical, either—you have one guarantor in any event.

The most efficient vehicles in the market today are Ginnie Mae, Fannie Mae, and Freddie Mac. To get away from those programs I think is a reduction in efficiency and the best pricing for this program.

The flow. I think there are two elements in liquidity which are crucial to investors in securities that are being created out of these programs. One is the continuous flow of new issues, rather than a sporadic flow. The second is the total volume that builds up in outstandings, in very specific security forms over a period of time.

I had one question that you may or may not have considered. You talked about a $3 billion here in the proposal. Do you have any idea as to the total dollars of mortgages that the $3 billion might translate to? Any idea in terms of range?

Senator **D'Amato**. I certainly do not. I would look to the experts here to give us an idea. First of all, $3 billion would not go into the mortgages, but it would take a significant percentage. I think it would be interesting, depending upon the conditions that are established for downpayment, et cetera, as those dollars would be used, to attempt to come up with a figure as to what a $1 billion leverage in housing would be.

Leland, do you have any idea? Could you share with us some of your thoughts in this area?

Mr. **Brendsel**. I would like to talk a little bit about the evolution of the secondary market here, and come back and try to answer that.

Senator D'**Amato**. I do not know if you want to continue.

Mr. **Hays**. No, I want to hear Leland's ideas.

Mr. **Brendsel**. We have been working on the development of a secondary market, particularly for multifamily mortgages, since about 1971. First of all, I think it is very important to have liquidity and standardization to some degree in these mortgages, as we have had.

Senator D'**Amato**. It becomes necessary. What you are saying is, if you are really going to sell the package, you have got to have this.

Mr. **Brendsel**. This does not mean that you have to have one single mortgage instrument type, as you find on the single-family side. We have a few basic types, four or five, and I think that would be sufficient on the multifamily side.

Mr. **Hays**. The fewer, the better.

Mr. **Brendsel**. The fewer, the better. But there has to be enough to provide flexibility to the borrowers, to the investors in these properties, and so forth, that is attractive in tailoring their own individual situation.

I think we are close to that today, in terms of the development of the secondary market for multifamily mortgages. We have been experimenting with multifamily mortgages for quite a while. We have had some successes, we have had some failures. But right now—in fact, I was struck by the number of $3 billion you are talking about. It will basically buy about $3 billion worth of multifamily mortgages, as I said, that really carry rents below HUD fair-market value.

I do think it important in this legislation, though, that one thing that has not existed is the close working relationships, for example, between Freddie Mac and state and local governments. I see the HOME Corporation as facilitating that kind of working relationship on an ongoing basis.

So I think that is a very important part, and we can offer some technical expertise. We can also learn a lot from them, and together we can work out programs that best meet the needs.

With regard to maybe the suggestion to how one could enhance the legislation, as I said before, I think one of the great difficulties and challenges is the underwriting, the assessment of the quality of the mortgages, and evaluating the individual borrower and property and so forth. That is where the credit enhancement mechanism can help play a role.

At this point, the legislation is pretty broad with regard to what is the form of the credit enhancements. Does it apply to mortgages? Does it apply to securities? I would favor having fairly broad credit enhancement provisions in there, so that you do have some flexibility and tailoring to individual situations.

With regard to what kind of leverage does $3 billion or $1 billion provide in terms of lending, that of course depends ultimately on how much support or subsidy you want to provide to the individual mortgages and the properties. It is easy to see where that could lever into that.

Senator D'AMATO. Do you get a 6-to-1 or 7-to-1 ratio?

Mr. BRENDSEL. Yes.

Senator D'AMATO. Is that a fair kind of thing?

Mr. BRENDSEL. That would be fair.

Mr. LASKO. I am compulsive with pad and paper. $1 billion, if you used it to spend all on moderate-income housing and just wrote a check, it is 15,000 units. We are obviously talking about trying to stretch it a lot further than that. So if you have got 5 or 6 or 7-to-1 per billion dollars, you may be at best talking about 100,000 units. The $3 billion would be 300,000 units.

Senator D'AMATO. If you can get a billion into the system, and you get 100,000 additional units annually, that is not too bad, is it?

Mr. EICHLER. Senator, with regard to this, I will just ask a question here of people who are specialists in financing. But you have got a spectrum of housing problems here. At the very low end, you have got a very high risk. In other words, you have got to supply a large guarantee for the amount of money at that very low end, because the economics are not there.

Senator D'AMATO. The subsidy is going to be deeper.

Mr. EICHLER. It is going to be much deeper.

Senator D'AMATO. And there are those at the other end where a $2,000 or $3,000 per unit infusion will make it possible for that family.

Mr. EICHLER. Precisely.

Senator D'AMATO. That would give you much greater leverage.

Mr. EICHLER. So the question is——

Senator D'AMATO. They get a 20-to-1 ratio. Whereas, on the other side, there is only a ratio of about 4-to-1.

Mr. EICHLER. The question is, can the guarantee be tailored according to the risk of the project, so that on the very moderate risk side you only guarantee that very nominal part that is not covered. That really stretches your dollars.

Senator D'AMATO. Mr. Dale?

Mr. DALE. I would like to underscore one real strength in the HOME Corporation concept, which is the notion of creating an institutional stability in the Federal Government that can be a leader in low- and moderate-income housing finance.

Certainly, the discussions that we will have at the end of the 1990's, in terms of housing finance for low- and moderate-income families, will be very different from those we are having today, in the financial tools that are available.

Senator D'AMATO. Do you think we can put together a group that has the expertise? Because I am wondering—think about it.

Mr. DALE. I think it will be a lot easier to do in the new institutional structure than it would be to try and pull from that which already exists. It is no foregone conclusion that it will be successful, but I would hope that it would be.

The point—and it has really been made in several ways, but I wanted to reiterate it—is that I think we might want to work on refinements in the HOME Corporation bill. I think it is broad enough to accommodate this. I am just not sure that it is all that clear to many of us how we can work to bring credit quality through the HOME Corporation and through its underwriting standardization and so on, to make loans good investments to private investors; to enhance their appeal to private investors and maybe use the HOME Corporation in that way to add a little bit of, if you will, taking credit quality risks that maybe private investors are not quite as willing to take today; and by taking those very small risks, have a much larger benefit by bringing the standard product to the secondary market.

It seems to me that the secondary market is quite well developed, between what Freddie Mac is doing and what Fannie Mae is doing and what Ginnie Mae and other institutions are doing. Standardization, liquidity, those tools, and good credit quality from the agencies are all in place.

Clearly, in the low- and moderate-income multifamily financing system, we see deals structured today that have relatively good credit quality first mortgage loans, but that may only be 40 percent of the financing that is needed, if you are talking about a low-income rental project. And then, you layer on some state and local financing, maybe some higher-risk secondary financing, some equity, some tax credits, and by the time you are done you have got a very complex package that all went to produce 100 units of housing.

It seems to me that HOME can be a leader in maybe making that process a little simpler and bringing lower-cost overall financing to the table.

Senator D'AMATO. Now, Kirsten Moy with the Equitable Insurance Co., it is my understanding that you are involved in assembling a task force to make recommendations about the secondary market for low-income family housing. I wonder if you could tell us a little more about this task force, and whether it will make recommendations pertaining to this legislation so that we can take it into account? What is the time frame of this task force?

KIRSTEN S. MOY

Ms. MOY. The genesis of the task force was that a number of our industry leaders, including Dick Schweiker, the president of the American Council of Life Insurance, went in to see Secretary Kemp on April 4. The idea was not original to us. It had to do with a number of people around this table, to see whether we could make the secondary market work better for low- and moderate-income housing.

A number of the problems that plagued that market, especially on the multifamily side have been discussed by the people around the table today. What is being proposed is a major research and development effort that would involve a variety of financial institutions, aside from insurance companies, commercial banks, savings institutions, mortgage bankers, Fannie, Freddie, developers, syndicators nonprofits, and investors such as foundations and pension funds, and seeing what obstacles are blocking that market, and indeed answering some of the questions that you are posing today.

We understand that the Secretary is interested and will very possibly convene such a task force. And if some of the basic research work can be done over the summer, there may be some preliminary recommendations that would be available after the first of the year, which would hopefully serve as input to what we are doing here.

Senator D'AMATO. I gather, from all of those who have made comments, that the HOME Corporation, if this is going to be the vehicle by which it attempts to implement and help assist as it relates to the secondary market, would not really have to have legislation, per se, at this time, but that there would be the effect of policy planning, standardization, and providing enough leeway to meet the various housing needs that really is the key ingredient. Is that correct?

I interrupted you, there. But that would seem to be the case.

Ms. MOY. It is probably premature to guess the results of the research, and we are not quite sure what we are going to find. It seems to be a complex question. So there may indeed be things—my guess is that there would be a variety of things, some of which might require legislation.

Mr. SCHWARTZ. I agree with your comment, and want to come back in this connection to that same point I think I made initially, which is that any of the units that are done, whether for rental or homeownership—and our rental programs are now expanding considerably—in the end depend upon some sort of deep subsidy.

Our State finance agency—and here, I will agree with Mr. Duvernay—our finance agency, as opposed to the agency that will deal with the state HOME money, has been very responsive. But usually, it boils down to going to them and saying, "We have a package here." There is a limit to how much they can subsidize and, unless the other sources are funding for deep subsidy, that are available. Then they cannot act, because the rest of the package is not together.

The HOME Corporation provides that gap. Frankly, the other element in this legislation which has not been mentioned particularly, but I will put it on the table, which would be very helpful, is the consolidation of section 8 and vouchers into one single subsidy program.

This is patently absurd, frankly, to have these two different systems. I constantly have to be reminded and briefed by my staff as to what the exact distinctions between the two of them are. I have one that might well be more carefully targeted to project-based rental units, so developers can get some incentive for putting projects together and, frankly, making certain that the quality of them is made available and increases.

Coupled with the HOME Corporation, it would I think do more to activate the ability of finance agencies to be responsive here than anything that we would do directly with the finance agencies.

Mr. MARKUS. If I could, I would like to first make a comment on the issue discussed before, about the continued affordability of any of the units that are created here. Just a brief comment.

At least in my experience—and I indicated before, I was involved in the housing efforts in New York City—you had better do it upfront, because any change that you attempt to make—and I could instruct the Senator about some of the debate taking place in New York around the Mitchell-Lama kind of program, which has several kinds of issues. If you do not do it up-front, people believe that there is an entitlement associated with the increased equity appreciation, and there is a whole new issue that is raised.

Therefore, I think it is very, very important that those goals be defined, and the program set out up-front, whatever the public policy decision is.

On the question of the secondary market and access to the secondary market, I would separate. There are two separate issues, I think, on the secondary market question. The first is access. Can you sell the obligations guaranteed by the HOME Corporation? I think the answer is clearly, yes, because the HOME Corporation, as contemplated in the statute, is a full faith and credit entity of the United States.

So the second question is, will it be effectively priced in order to achieve the amounts of leverage that you want, et cetera? I stepped back and therefore asked, if you have access, that is not enough. You want to make sure you have effective pricing.

The question I would ask—and this is only in the rhetorical sense—is, who needs it? Who needs the HOME Corporation credit enhancement? The answer is, you need it if you are trying to play through a specific example, and see what goal, what use you can put the HOME Corporation credit enhancement to.

And I would like to just describe what I believe to be a typical project, and go back to the earlier statement about the effect of demand-raising capacity, which is in the $3 billion of subsidy money, versus the secondary market.

You are going to have a typical transaction with which you are going to attempt to meet the low-income requirement set forth by the statute.

We heard earlier debate about that it should be more deeply targeted. Clearly, the leverage that will be provided by $1 billion, or $3 billion, will depend on how deep you target that subsidy, so it is very difficult, unless you see where you are, to really decide what level of leverage you are going to get.

Let's assume that it really does not make any difference. Larry before alluded to the fact that in a typical transaction only 40 percent is the portion that you might see that accesses the capital market. The other 60 percent is made up of various subsidies.

In this particular case, in these transactions, one big issue is the interplay and the access to, if any, tax-exempt finance. Because if you have access with the home guarantee to tax-exempt finance, which at least to my belief in the current state of the law will say yes, you therefore can do even greater leveraging of the HOME Corporation funds.

The second part is the low-income tax credit, which hopefully can dovetail with this, and its prohibitions, if any, which exist in today's statute—not prohibitions, but disincentives for use of tax-exempt financing. All of this has to do, it seems to me, with the leverage and the market access, and what-have-you.

Then the next question comes on the credit enhancement side. OK, you now have a situation, who can do this? I would submit that the HOME Corporation credit enhancement function need not exist if the HOME Corporation is not going to take more credit risk—and I am not going to define what that is—than Fannie Mae and Freddie Mac are willing to take today.

Because I can guarantee you that, no matter what volume figure you posit, the leverage will bring $6 billion or $7 billion. Fannie Mae, Freddie Mac, and Ginnie Mae will have better market pricing, better execution in the market. So that you have to really face up to the issue that the HOME Corporation's credit enhancement function will be a riskier function than private investors. And that is the value added.

So I posed the question earlier: Why do we need it? The answer is, because it is going to have to take a little more risk, and you are going to have to really take a hard look at the underwriting standards, the interplay of the underwriting standards, to the credit enhancement fee it is going to charge. And I think you really have to spend some time and really make sure that you are fitting it into the context, into the existing system.

My feeling is that the existing secondary market entities, Fannie, Freddie, Ginnie, and State and local housing agencies which are just localized mortgage market intervenors, if you will, are the ones that you want to be looking through. Because their names are established, and their volume and their understanding and their market access at the right price are well established.

One need only look, for example, at the SBA program, I think, which has got full faith and credit, but does not get the most effective pricing, because of volume and liquidity issues.

Senator D'AMATO. Mr. Lasko?

Mr. LASKO. Let me follow up on what Mr. Markus said, but also respond to something that you asked for.

Senator D'AMATO. Well, he opened up a lot of areas here.

Mr. LASKO. You asked initially, a few minutes ago, whether the things we have talked about, in terms of creative focus, are doable under the legislation as written. I would submit to you that they are.

The bill is drawn very broadly, in good part. The securitizing part of it has tracked the Ginnie Mae legislation, which is written very broadly. The point I want to make is this; that therefore, a great deal of whether it works or not will depend on the people at HUD who run it, in the sense of commitment.

Mr. Markus listed a large number of things relating to the amount of risk that the agency is willing to take. Our understanding of the purpose of the bill and the purpose that people envision around the table here, is that it would do things that are new, different, and creative, and that involve some risk. And that is the whole reason for getting into this.

It takes a good number of rather bright and well-intentioned people, and also people with good judgment, to run such a program. The bill is written so broadly, and I think that is the way it should be.

I would just say to you, Senator D'Amato and Senator Cranston, that its success, therefore, is going to depend on the willingness of the administration to commit the people, to hire enough, to not put constraints in terms of a lot of rules and fees and so forth on it. And they can either make or break it as an idea in a short period of time, depending on how much commitment they have and what their attitude is.

Senator D'AMATO. It would seem to me that they would need a good strong advisory board, utilizing the people from Fannie Mae, Freddie Mac, and others, to assist. This is an area that, without that kind of expertise and genuine commitment, they could find themselves in a great deal of trouble; or the program is simply not going to be effective.

So too, if you have the commitment, you could get the pool of talent to help in an advisory capacity, and get one or two talented people who understand and make the commitment to public service. That would be an extraordinary kind of situation. It seems to me that that is certainly true.

I would go right around the table. Mr. Hays, then Mr. Lawson.

Mr. HAYS. First of all, I think whether you are talking about a program or parts of the program being administered by one of the agencies, by other financial institutions, by mortgage bankers, and by State or local housing agencies, it should all be considered the same, as far as funneling it all through the same vehicle or vehicles that are established ideally through one or more of the three housing agencies. There should not have to be a different form of mortgage that comes to the secondary market.

The second thing is that, from the viewpoint of underwriting and the integrity of underwriting, Fannie Mae and Freddie Mac have clearly set the standard in this country for underwriting. For the long-term integrity of this program, I would urge them to use that standard.

If you then are saying, "What we will do is to create the units we can by subsidizing in some fashion down to that standard," what you may be doing is eliminating the need for this substantial additional overlay of credit. Because if you satisfied Fannie Mae, Freddie Mac, or Ginnie Mae, as far as the underwriting is concerned, and the vehicle that is being used is one of the security forms that they already have, and they do not see additional risk in these mortgages because of the underwriting, then that may either eliminate or very, very substantially reduce the need for an additional credit overlay.

Senator D'AMATO. Let me interrupt at this time.

I am going to ask those people who are here—and obviously, Leland and Mr. Dale—to respond. I would like your thoughts, and others too, but go ahead.

Mr. HAYS. That is the basic point. I would be anxious to hear if I am off-track, from either Leland or from Larry.

Senator D'AMATO. It seems to make some sense. We are going to come around.

ROBERT LAWSON

Mr. LAWSON. Robert Lawson, from the Homebuilders.

I see the credit guarantee as something broader than is being viewed. And I think Larry Dale related to it earlier in the conversation. It can guarantee different levels of the credit or the security necessary to bring these rents down under conventional Fannie Mae underwriting.

It might be that 40 percent of the costs are all that are eligible under that basis. Now somehow, we have to leverage money on top of that, to produce this housing.

Guarantees may be appropriate at certain levels of that, and I think the term "guarantee" needs to be viewed broadly, and in reading the legislation I certainly felt it was defined broadly. However, there may be an area where we could reduce costs, which we really have not talked much today about: what do we do to reduce costs and therefore to get these subsidies to go further by offering some type of liquidity guarantee which might allow someone to go into the market with short-term investments, i.e., commercial paper of that sort, to lower the true interest cost that is passed through on these. I think that should be investigated, or certainly allowed as something within the law that could be done.

And again, to go a little outside the mortgage area, I think it is also important, feeding back on the plan portion that the cities developed, that the law encourage the cities that are getting the support to reduce the regulation and adopt the cost-cutting things that have been demonstrated by HUD's joint venture for affordable housing, and surely contribute to a reduction of costs, which I feel is a very necessary part of really making these funds go a long way and really being able to best use them to provide low-income housing.

Senator D'AMATO. Barry?

Mr. ZIGAS. Thank you, Senator.

I really cannot resist comment after listening to the conversation on increased access to the capital markets and so on. Two reactions: One, I really think it is important that we pause a minute and look outside the context of the National Affordable Housing Act.

In the next couple of weeks, your committee is going to be meeting in conference on the FSLIC legislation. The House is going forward with a provision that will require within the Federal Home Loan Bank structure the establishment of an affordable housing fund using the cash advance mechanisms of the Federal Home Loan banks.

Right there, by the committee's estimates on the House side, you could generate with an internal subsidy, using profits on advance lending, $7½ billion in subsidized mortgage lending for affordable housing.

I would just hope that, as we look at the overall scheme here, as we are talking about affecting the pool of capital and having these credit guarantees, how do we get a little bit of a leg up on capital—that we not restrain ourselves in looking at this legislation alone.

Your FSLIC restructuring and Bank Board restructuring is an opportunity to identify a source of capital that is now being used for just about anything the member institutions want to. The bill in the House would isolate some portion of those transactions to require it to be invested in low-income housing. And you are asking about leveraging.

To me, here is one of the most exciting leveraging possibilities that we have seen in years, coming through. And it is not in this bill, yet it is so essential to the success of the legislation here, by freeing-up this capital as much as 200 basis points in subsidies. I really feel I would be remiss if I did not encourage the committee to see that as a very linked piece.

The second thing I guess I would say is, I am concerned a little bit—and I think other people have said this in a different way—that when we are talking about meeting the needs of very low-income people, the concentration on the guarantee formats, and what does the HOME Corporation add to the mix, it is in some sense looking through the wrong end of the telescope. Because, when you get down to the housing costs of very low-income people, the differences that the credit guarantees offer really do not get you there. I think all of the lenders here who are involved in this know that.

Some of the lenders here are aggressively involved in the subsidy mechanism, so they can get involved. I hope we can spend a little more time on discussing that, because I think what the bill has proposed is a way of decentralizing administration of the national housing program.

As I said earlier, I think there are a lot of strengths to that, because of the closeness to the conditions. By the same token, there are a lot of issues in the bill that are left sort of to general interpretation. You are leaving HUD a great deal of discretion and frankly, the recipients of these funds with a great deal of discretion.

In particular, let me just cite a few. The citizen participation requirements for the development of plans, for the review of plans and programs, to us are really very inadequate. As you know, we amended the community involvement statute two years ago to expand the requirements that cities and states have to go through. I would urge the committee to incorporate at least that level of participation.

We are now talking about authorizing many jurisdictions to utilize this money. One of the most effective means of monitoring that we are going to have is to have these plans and processes and reports open to as much public review as possible. Because it is in that venue that things will likely take place.

The definition of "nonprofit organization," I congratulate you. I could not be more happy about the emphasis on nonprofit and tenant and resident controlled organizations that the bill highlights.

Two comments on that. One, I think it is important to give much more guidance to State and local governments about what nonprofits we are intending to assist, what priority kinds of organizations are we trying to assist in the definition. And the bill is really very general. And also, while there was a 10 percent set-aside, there is no comment requirement that in those jurisdictions that have more capacity in that sector there be priorities to utilizing them to create permanent housing for community-based institutions.

We clearly have mechanisms for what happens if there are not enough, but we do not affirmatively say that we would like to see communities put some priority on the use of these because of our commitment to permanently affordable housing and our trying to build community institutions as we are trying to build institutions in the Federal Government.

Finally, I would say—and it may be strange to hear this from me—I am very concerned about the lack of direct funding for administration for the grantees in this program. The more we look at it, the more concerned we are that the real cost of housing programs at the State and local government cannot simply be loaded into the projects and cannot be loaded onto State and local governments, with the expectation that they are sort of out there just waiting to appropriate money to provide housing for very low-income people.

I would seriously urge the committee to consider a separate line item that tracks with the HOP's, and that provides funding for administration. I think that is a more critical area.

One final thing to toss out. It seems to me, given the budget situation that we have come through now, that even $3 billion, as proposed in the bill, is probably unlikely to be possible in the current budget constraints. That raises to me serious issues about the formula allocation, which I support—whether it is a sufficient amount of money. But with an insufficient amount, very much less than you have proposed to put in here, how the operation of the formula will really work.

I think it would be a terrible tragedy if we enact a program with the best of intentions that provides so little capital in any one jurisdiction, because it is operated through a formula, that nobody can really prove how it works.

I would urge that we give some thought about possibly triggering direct allocations after appropriations get to a certain point, and until then operating on somewhat of a discretionary basis, using the same model of State and local allocation. I would request some conversation.

Senator D'AMATO. I think that is a very legitimate point, given the limited resources as a practical matter—and I am going to ask our staff minority and majority directors—it is important to factor that in. It is a very important point.

In my opinion, we are not going to get anywhere near the $3 billion. If we can apportion it out, we are going to be lucky, but what portion and what kind of mechanism should we use to trigger in rather than have nickels and dimes being distributed throughout so that we never get to see the impact of the program?

I think that is going to be controversial, tremendously so, but better to do something controversial than pass this bill and do a great disservice, at least to that aspect of it, because there are insufficient funds to make it meaningful.

You raise a good point. I am going to go right around the room. Leland.

It is a very sobering analysis. I think also I would be remiss if I didn't say to you that there obviously is a conflict as it relates to the needs.

I am not discounting—you and I have talked in the past about the needs of the poorest of the poor, but I think we also have to be very conscious in this country that there are a growing number of working people, working families, who are not considered in the traditional sense poor, who are facing the same kinds of problems—near homelessness, border line situations, and then those who thirst for an opportunity for homeownership and it will be denied to them.

I just don't think that we can afford as a society to create, I think, what might be an intolerable—a backlash against the poor by disenfranchising and by failure to allocate funds to give them homes and opportunity for decent affordable housing, which is where they are working and paying taxes and trying to keep the family together.

I think that is important because if we don't give them some hope they will become rather frustrated, and they take that frustration out on the poorest of the poor by saying, here I am out there struggling, out there working, out there paying taxes, and there is nothing to give me that little step up.

So we have just got to balance that. I don't think that you are saying or you are suggesting that we forget their needs. I think those are the dynamics that we have, and it is tough.

Mr. **Zigas**. I appreciate that. I would just comment. I think you raise an important point, and I would agree with you we are not in any way interested in polarizing support for these programs.

I would say, though, that we have to keep in mind that generally 50 percent of median in the economy is 100 percent of renter median and the people you are discussing, people who are cut out of the housing market, they tend to be renters, their income is substantially lower than the incomes of owners are today, and when you are targeting to 50 percent the area median in many jurisdictions you are in fact targeting people who, as Joel said, are close to participating in the home market. They have relatively high incomes. We are not operating off the renter median and we are not operating in the HUD programs off of the poverty level, which of course is substantially lower than 50 percent of median.

I think we have to keep that in mind because I think you are getting in the $15,000 to $20,000 range, at people who are clearly working, who are clearly struggling to make ends meet, people who have an income. Half the filers who file income taxes have incomes below $20,000. It seems to me very important to keep that in mind as we target.

I think the issue of supply that was raised cuts the same way. Relying on more supply has the drawback of helping to reinforce patterns of racial and economic segregation because it doesn't do anything to add stock in certain areas, and again to me that cuts most hard against working people who make up the majority of the people we are trying to help.

So I think the committee needs to keep that target area in mind because of all the interactions that it creates.

Senator D'**Amato**. Leland.

Mr. **Brendsel**. Thanks, Senator.

The scarcity of funds to support housing and subsidies——

Senator D'**Amato**. Leland, I would like to get back to the point that Mr. Hays made. Then you can comment on that.

We are wide ranging in our discussion, but I think it is an interesting format that really provides us an opportunity to comment on things that we feel strongly about.

Go ahead.

Mr. **Brendsel**. Let me reinforce that. The spirit of this legislation, the spirit of the HOME Corporation, as I understand it, is to make more effective use of our very limited resources, and I congratulate you for that.

Let me comment a little bit on the point that Brian raised and first talk about the types of things we are now able to structure where the HOME Corporation I think adds value in a couple of different ways. One might be the credit enhancement mechanism.

Right now we are able to purchase loans that do involve subsidies. We do a variety of loans on multifamily apartments where there is a subsidy maybe by a city, such as Atlanta, or Federal subsidies for rehabilitation of a property, combined with a lender getting involved and Freddie Mac buying the mortgage loan on a takeout. Those mortgage loans—we have done many of these and they meet our underwriting guidelines, and we are satisfied that those are investment quality mortgages.

What value added does HOME Corporation provide to that? I think it is still a situation where the HOME Corporation is a focal point. It is the one-stop shopping phrase where Freddie Mac as well as Federal and local programs, and so forth, become accessible in one place at this HOME Corporation.

I think that is very important. That would be important to us, knowing what other opportunity is out there to structure that type of situation.

With regard then to the credit enhancement mechanism, for those mortgages that do meet our underwriting guidelines, of course, then there may not be as great a need for additional credit enhancement.

Senator D'**Amato**. Wasn't the question shouldn't they meet that guideline? If that means a deeper subsidy, then would you not be doing a better job by seeing that there is—that you meet those same criteria?

Mr. **Brendsel**. I think there may be situations where having the credit enhancement might facilitate a mortgage loan on a property that is of tremendous benefit to the local community.

I was struck by some mortgages that we aren't able to make because there is too little equity in the project. Nevertheless we feel that it might be a sound project. If there is very little equity in the project, particularly when you get into multifamily apartment lending and so forth, the risks become very large. We are allocating our money. We are just not able to meet that type of loan.

That is where the credit enhancement mechanism might be very important.

Mr. **Duvernay**. Senator, I would like to pick up a little bit on something Barry mentioned about the $3 billion maybe not coming in, depending on where the budget is. I would hope that in recognizing the reality of where we are we don't get caught up in long-term expectations that housing doesn't deserve $3 billion or more.

The $3 billion figure is not, I don't think, a figure that any of us believe will meet the housing need. The reality of the budget process may make it hard at the beginning, based on timing, to get to that figure, but in anything we do, I think, for the long term we have got to look at that as the goal, at least a minimum goal to get to, and base our regulations or base our program design on needing to get that figure, and when we compare—even though we are now getting housing back into the game because of your efforts and Senator Cranston's, what we don't want to do is lose the balance at the beginning, when you compare what goes into the budget allocation to what goes into other areas, housing doesn't compare at all.

I think the $3 billion is something we have got to try to continue to get.

I would also like to comment on just making sure that we continue the flexibility that has been written into this legislation. I think it is important. A lot of the committee's concerns that I hear, whether it is deeper targeting where necessary, whether it is providing rental units that need a combination of subsidies to work, what I would hate to see is, as we try and reach any one of those goals, we set up a program that doesn't allow for the use of some of the things we already have.

For instance, if we target too deeply here, we might not be able to use mortgage revenue bonds or mortgage credit certificates or low-income housing tax credits based on the parameters we place on these programs. I think because they are there, if we can be consistent in what we require here, we are able then to utilize all of those resources as we try and find a way to meet housing needs.

So I would ask for a continuation of flexibility and consistency.

Mr. **Sidor**. Thank you, Mr. Chairman. Three comments.

I think the income targeting is perfectly appropriate as has been drafted in the bill, and I think that it gives people the opportunity to do mixed income projects. It gives them the opportunity to stabilize neighborhoods, to perhaps disperse low income housing. I think that may be very important in the future in terms of getting housing and jobs close to one another.

I would like to underscore Mr. Schwartz' point from earlier that in terms of the deep subsidy, the deeper targeting, I applaud the bill's treatment of rental credits. I think that is extraordinarily significant. There may be some fine-tuning that needs to be done, but I think it is very important to make sure that the jurisdictions that are handling the HOP moneys have the ability to tie in rental credits in order to get the deep subsidy necessary to serve very low income people, as Barry so well advocates.

I also think that the incentive portion of this bill can get at some of the issues raised with low income targeting by rewarding those jurisdictions that really perform well in that regard. I think that the incentive portion of the bill gets at a point raised so well by Mr. Lawson in terms of taking actions relative to regulation to reduce the cost of housing and getting a sense of what is going on in that area and rewarding jurisdictions that move in that direction.

Finally, just to comment on Terry's point, I think keeping the flexibility is extraordinarily important. I think everyone should be accountable, and I think that Congress ought to require tough, good reporting and monitoring standards and after a while take a look at what has happened.

Maybe that is the time to sort of make some changes in the bill.

But you are embarking, I think, on a terribly exciting new venture and getting a lot of people involved in housing. It would be unfortunate, I think, to begin to sort of craft a bill that gets more specific and more narrow, and let's take a look with some good, tough accountability and some good monitoring and reporting and taking a look at the outyears in terms of making some changes as opposed to making them now.

Thank you.

Senator D'AMATO. Thank you very much.

Ms. MOY. There are two comments I want to make. One has to do with the credit enhancement issue, one having to do with one issue about the bill in which we see the need for some refinement.

I am hearing something that concerns me, which is there seems to be an assumption here that the projects, that the HOP-assisted projects will be in some way riskier than other types of housing, that, for instance, low income housing is generically and inherently riskier than perhaps market rate housing.

And as a lender, I cannot agree with that. I think it is a different type of risk, and it needs to be underwritten in a different way, but it is not necessarily riskier and I would hate to leave the impression that what the HOME Corporation will be doing would be necessarily just insuring projects with greater risk.

The other thing that perhaps I would like to see a little attention given to is that the language of the bill quite frequently mentions the need to encourage public/private partnerships and in helping states and localities reach out to the private sector to involve them in affordable housing.

What we think the bill needs are clearer and more specific guidelines for States and localities as to how they would do this. Perhaps there could be some guidelines or criteria in financing of each package that at least suggests a certain level of private sector financing in each piece.

We agree that States and localities have different sophistication in putting projects together, and I think some of them could use a little help in this area.

Senator D'AMATO. Thank you.

Mr. Dale.

Mr. DALE. First of all, I would like to respond to Brian's question and then make a couple of other points.

We obviously feel like we have come up with some reasonable multifamily underwriting standards and criteria, and I think Freddie Mac, Ginnie Mae, and FHA would argue similarly.

I would be the first one to say, however, that we are not perfect and there are many circumstances where we probably lend a little bit too much, and there are others where we may not lend quite enough.

And I guess what I was suggesting earlier—and I think the tenor of the suggestions earlier—is certainly to build upon the experience of the agencies. We should not throw that away. That is good valuable experience, and there are some fairly good standards there. But maybe to consciously take some additional risks in certain types of lending that the agencies don't take.

There's some good, maybe, examples, and maybe these work, maybe they don't. But one can certainly see State or local government, who is intimately familiar with the community's revitalization, with a nonprofit or profit-motivated sponsor's experience and track record and with sources of local government support or State government support, that may be willing to lend far more to make a loan that is far higher than would meet a normal secondary market standard is a good, safe loan.

It is conceivable to me that that Government may indeed be willing to partially guarantee the top part of that loan, but through a combination of those types of loans moving into the HOME Corporation, the HOME Corporation could overlay that guarantee, maybe even on a partial basis as opposed to a full basis, and have a very liquid set of instruments or pool of mortgages that could be sold into the secondary marketplace using the Fannie Mae or the Freddie Mac or the Ginnie Mae credit and getting the liquidity advantages and the volume advantages that those credits would offer.

So it seems to me there are some constructive ideas that might go beyond just adopting the agency standards per se, but clearly they are the standards that I think we can build upon.

Mr. **Hays**. May I make just one comment, Senator, please?

I think what we are talking about here, though, is to the extent that there is a credit overlay of some kind it is to satisfy Fannie Mae or Freddie Mac or Ginnie Mae. It is not to satisfy the investor because the basic guarantee of that agency is sufficient to satisfy the investor by itself.

Mr. **Dale**. I would totally agree with that.

Senator D'**Amato**. What you are saying is that by some innovative measures, whether it is a guarantee at the local municipality or an additional subsidy, that you would be still attaining the same kind of standards that Freddie Mac and Ginnie Mae have put forth, isn't that right? Isn't that what you are really coming down to?

Mr. **Dale**. I think what the suggestion there was, that the standards of risk, which are relatively low tolerance standards of risk when we are the lender/investor, that Freddie Mac or Ginnie Mae or FHA or Fannie Mae, I don't think you can reasonably expect those to be much different than they are today.

But there are a variety of ways that the State and local governments and the HOME Corporation could help make more dollars available at those low costs by helping achieve those standards.

Mr. **Hays**. It might be easier to provide a guarantee or cheaper to provide a guarantee that satisfies one of the agencies than to provide a guarantee which in effect would be the equivalent of a Treasury guarantee on a security for the investor.

Mr. **Dale**. I agree, and the aggregation concept, the HOME Corporation's ability to work with State and local governments and then aggregate those loans, may give some good breadth and some ability to provide that kind of guarantee.

A good example of that is, as you know, we have been a major investor in low income housing tax credits.

Senator D'**Amato**. A lot in New York City.

Mr. **Dale**. Some 22 projects and $40 million in New York City.

I am responsible for those equity investments and the set of glasses that I bring to the table in evaluating the equity investments that we make is very different from the pair of glasses that I bring to the table when I look at becoming the investor in a mortgage loan where that mortgage loan is the bottom 20, 30, 40, or 50 percent of a rental housing project. That is indeed a tax credit rental housing project because we also do that; we come in and buy mortgage loans where the mortgage loan is supporting a low income housing tax credit, where there is another equity investor on the tax credit side.

There are just very different standards that one brings to the table there, and if we are focusing on the lender standard it is because that is where the higher degree of leverage is.

The other thing that I wanted to reinforce before closing is our experience which, as you know, both in tax credits and the public finance area and in a number of other low and moderate income areas has been pretty extensive and has really reinforced the development of State and local capacity for program administration, and I can't commend this committee enough for the leadership that you have had and the spark that you have given to those efforts, but as one who has been in this business for a number of years, one could not comfortably rely on the degree of delegation, if you will, of responsibility that you contemplate in the National Affordable Housing Act 10 years ago that we can today.

I feel very confident today that between what is already there and what is clearly growing in our State and local governments in terms of capacity to administer, to effectively administer housing programs, that this model has great potential for success, and I think that is a tribute to the efforts of the committee.

Mr. Webdale. Following up on some of Mr. Dale's comments, especially in terms of the credit enhancement itself, as a practitioner in housing, the credit enhancement, the enhancement itself, not only gives us the opportunity for selling the particular instrument, but it is also something that presents a problem to us.

The problem we have faced over the years is that credit enhancement costs money, and that money comes out of the operating budget of that particular project and once again affects how low the rents are going to be.

We have always come up against that wall when we have tried to put these things together, and the new HOME Corporation must be concerned that that enhancement becomes a very inexpensive kind of thing for the locality, this is extraordinarily important.

On top of that, local commitments in terms of debt are not easily given. I know in my community that takes a referendum if we guarantee a bond or we guarantee a note. So it is difficult to fall back on the particular community to give that kind of a guarantee.

Also, in the whole process of building, there is only so deep you can go with capital subsidies. Even if you do, you are still not going to get the units affordable down to the persons of lowest income. I think the bill is correct in targeting to a certain level and then looking to the rental credits to get it down to the very, very low income individuals. That way it gives us a much better chance at more production, in the community, of housing that is going to be of a permanent nature for low and moderate income.

Finally, there is one thing which hasn't come up in discussions right now, and that is what the localities and what the states are going to bring to the table.

I do come from a community that does put a lot of cash in, but I know that across the United States there are a lot of communities that don't necessarily and cannot necessarily bring cash or land or those kinds of things in sufficient dollar amounts to meet the requirements of the act. But they do bring something that costs some real money, and that is called tax abatement. That is really taking money out of the public treasury each time.

I would ask that you look at considering tax abatements as part of a locality's contribution when ascertaining the amount and formula that they are putting in themselves.

Mr. **Eichler**. I would like to focus on a few aspects that we have overlooked a little bit today. We have discussed a lot of information about financing the program and in the structure of the act, which I think is all commendable. The problem is complicated. There is no question about that, and I don't think anyone in the business can legitimately sit back and say that some form of targeting is necessary to solve some of the very specific problems, that mixed income projects would be a help, State and local matching. You know, all of these different formats would be a help.

I would like to reemphasize that I think the private sector and the partnership is an important ingredient here. The private sector and the U.S. Government in the past 15 years has produced more housing than any other form, and without getting into a difficult situation with Barry because I agree with the point he is trying to make about taking care of the very low income, I would still like to reemphasize the fact that supply of housing is an important factor and the supply is limited.

People who have the capability push down into available housing units that are on the marketplace and push out people who cannot afford to live in those units. I don't think there is any way that we can generate enough money through the Government programs where we can specifically target the solution to the very, very low income loan. I think it has to be a cooperative effort to be able to do that, and the private sector has to play an important part in it.

The other thing that I would like to point out is that we ought to think a little bit about the product, and one of the problems in getting a product to the marketplace is controlling the cost of it.

That includes issues that go to zoning, site planning, architectural controls, flexibility, and the right kind of design to maintain a high quality product with a very low cost factor attached to it.

Those are super critical. Some of the changes in site planning procedures, zoning procedures, and building codes in fact could maybe even qualify for matching because they are real cost saving devices if they are properly utilized.

I think the private sector can help there in that particular area, making sure that the product comes to market in the right format and that it is workable and has a good life.

One additional point I would like to make. This just occurred to me while people were talking about it, and we were talking about the fact that housing reaches a point where the value gets driven up and you want to try to keep the housing stock available for people who need it.

I am wondering whether one way to do that might be to let some of that housing stock rise to market, take the profits that come off of it, and have it be reinvested back into the program for providing financing.

In fact, the HOME Corporation becomes a partner with people who buy the housing or are in the rental process. So some of the funds that are generated when it does come back to market go back into the program.

Senator **Cranston**. That is an interesting thought.

On credit enhancement, do any of you have any other insights on that particular topic?

Mr. **Rubenzahl**. I would just like to say one thing briefly. No one has mentioned here the role of banks and S&L's that are playing in financing low income projects. I guess there is no real bankers here.

What we have experienced is that the secondary market, important as it may be, is not really so important any more. In fact, I would say in the last 20 or more deals that we have been involved with not one of them has used the secondary market mechanism to finance it.

What we have seen happen over the last 5 or 10 years—and I think the HMDA and the CRA is a big piece of where this has come from—is that banks and S&L's have finally realized that lending for low income housing, using the same kinds of loan to value and debt service coverage underwriting criteria that they use in their normal loans, are perfectly reasonable and sound loans, and they are now making them, at least in the jurisdictions I am working in.

We have an experience in California with a group called SAMCO, Savings Association Mortgage Company, which is a lender that is owned by about 40 other lenders—it is simply a lender—they have been making loans now for 20 years where 50 percent of the units must be affordable to people below 50 percent of median. They have yet to have a default over 20 years of work, and while I think it is admirable to talk about credit enhancements and making the secondary market work well, the fact is that the market itself at the local level is already beginning to work much better than it used to.

I just don't want to lose sight of that.

Mr. **Lawson**. I would suggest that is probably not a nationwide circumstance. [Laughter.]

Second, I suggest that the production of low and moderate income housing resources during that period of time is certainly not anything that can sustain the needs of the country.

Mr. **Rubenzahl**. I am not saying it is sufficient.

Mr. **Lawson**. Certainly. Let's concentrate on expanding the secondary market, as a builder/developer, that I can see we need without question. I just don't want to see that very important aspect of this bill questioned at all.

Senator **Cranston**. On the subject of credit enhancement, I think we can make some improvements in the bill, and I would like to suggest that we set up a working group to work with Don Campbell on the staff on that particular topic.

Any of you that would like to serve on that group, please let Don know, and we will try to improve that section as we go along, and we will probably include a few people who are not present today in that group.

One question that has arisen that I would like to ask your advice on is the following:

While we have had a lot of emphasis on the homeless and the near homeless and the need for low cost housing and specialized housing, we also, as you know, are considering what steps we can take to deal with affordable housing that have reasonably good incomes but can't come up with the downpayment or afford a home anywhere near where they work despite reasonably high incomes.

We are suggesting, among other things, that people be permitted to use their 401(k) or IRA's as collateral. We are suggesting that the FHA limits or ceilings be lifted high and that there be only a 3 percent downpayment requirement for first-time home buyers under certain specified conditions.

Still, there are concerns that that 3 percent might mean that there wouldn't be enough equity, that people could walk away from their loans.

I would like to ask your advice on two aspects of that. One, do you think that is a legitimate concern? Is 3 percent not enough to get people reasonably strongly committed to staying with the property?

Second, would it be possible to provide in some fashion that for the first year or some specified period that much more of the payment go into principle than into interest for a limited period? Would that be a feasible approach to give people a more rapid opportunity to acquire reasonable equity in the property?

Any comments on that idea?

Mr. **Markus**. I think on the first one, the question of equity, I think the statistics—and the rating agencies, Standard & Poor's and Moody's, have a myriad of statistics that they publish with their underwriting criteria for so-called whole loan transactions, which are non-Fannie or Freddie—clearly there is a linear progression between less equity and the defaults.

But I think you as a public policy body are making that tradeoff. There is no linear situation where everybody puts out 3 percent are those who default, clearly not.

So I think those are the public policy tradeoffs you have to make in managing the FHA fund and the rest.

The best statistics I think I have seen is what the rating agencies have put together, and I think they would be more than willing to talk to you about their sensitivity.

Senator **Cranston**. What do they show?

Mr. **Markus**. They clearly show that the less equity, the more likelihood there is that people will walk and default, and each percentage is very, very important.

I mean, if you had 1 percent, it would be a lot more likely that people would default than 2 and 3. They have all that data.

On the second point, I am not sure you can do that. An investor in a 9-percent security needs 9 percent interest. The only way to raise additional accelerated amortization, if you will, is to increase that initial payment. So I don't think that that is at all possible without increasing the qualifying income for that home owner, and that would be directly opposite to your goal.

Senator **Cranston**. Any other comments?

Yes.

Mr. **Dale**. Yes. I would agree with Marvin in terms of our default experience vis-a-vis equity amounts. The only thing I question is whether it is linear, although I think he sort of changed that, too.

But there is a very strong correlation between downpayment and default history. But as you say, it is not that everybody who has a 97-percent loan defaults. So there clearly is a risk/reward tradeoff there, and it is an appropriate decision to be made in a public policy format.

Mr. **Markus**. Clearly, Larry, I would just say, a larger insurance premium, which does increase the cost, can easily overcompensate the risk, and if you are concerned about the cash available at closing versus cash on an ongoing basis, that I think is a legitimate tradeoff.

Mr. **Dale**. The point I wanted to underscore was the provisions in the bill that relate to the use of 401(k)'s or IRA type accounts, pretax accounts, for younger people to build an appropriate amount of downpayments. I think that is a real sleeper and a very positive sleeper. I think that could reshape the early—many, many young people I think will take advantage of that provision, and I think it could be a big boost to homeownership over time.

So I think from our perspective we see that as a very positive piece of the bill that could really help in responding to the homeownership needs of the group that seems to be having the toughest time getting homes.

Mr. **Lasko**. Just a quick follow-up, Senator Cranston.

I think, speaking from a group of lenders who make FHA/VA loans, we strongly support the bill you have already written in terms of the 3 percent downpayment up to the $50,000, certainly the higher mortgage limits, but I think we would also say it is really not unreasonable to look for some downpayment on a loan. As you have already heard, there is just no question that default rates and foreclosure rates relate more closely to the amount of downpayment than anything else, and I don't think it is unreasonable to ask for a 3-percent downpayment.

When you look at closing costs, sometimes paid by a builder or a lender or a seller, there may be very little real equity in the property, even with the 3 percent down payment.

So we would urge prudence in going much beyond that except perhaps on a very limited and targeted special purpose basis.

And I would just add, you of course know the experience with the VA program where 70 percent of the loans are zero downpayment, and both the program and the lenders are experiencing rather serious losses these days. So I don't think we want to open up areas of risk that could come back to haunt us in a few years and maybe reflect badly on well-intentioned programs and make future money more difficult to get.

Senator **Cranston**. How big is the risk if there is an accurate appraisal of the value?

Mr. **Lasko**. That is a very big "if." [Laughter.]

I think even most lenders would say—some of them might question me—but even most lenders would apply a plus or minus 2 percent accuracy rate to most appraisals. So when you get down to a 3 percent downpayment, you are running a very real possibility that you are already effectively down to a zero loan-to-value ratio.

Mr. SCHWARTZ. Not being in the lending industry myself, I can't speak to what the risks will be, however let's look at the other side of it.

We have a very unusual situation, as I gather, around the country in having both a somewhat depressed homeownership market, given that 70 percent of the housing stock of our cities is for homeownership, but with the extent of poverty, which makes it both accessible but not all that accessible, and the critical issue becomes the down payment.

Under block grant and other kinds of funding, we are subsidizing roughly 500 low income home owner rehabs through a variety of means, and I can tell you that this 3 percent, depending on where we would be putting people, 3 percent of some housing value as opposed to some portion of their income would rule them out of being able to become home owners.

The greatest crisis in our program now is in fact a widening gap between our availability to gain rental financing, which is growing even in the face of cutbacks because of all the tax credits, and our ability to subsidize homeownership.

From the standpoint of impact on low income neighborhoods, it becomes very serious because we can have homeownership as a source of stability within these neighborhoods. Increasingly, we are converting them from home owner neighborhoods to renter neighborhoods, and I am in a series of fights right now with racially mixed and economically mixed neighborhoods, fighting the extent of rental property that we have to subsidize given the availability of the specific subsidies here. There is an unavailability of comparable kinds of subsidies for home ownership.

So I would urge keeping this particular item in, and in Philadelphia, and I expect a few other cities like this, even this 3 percent of the value of the property is going to be a very difficult obstacle for low income people to overcome, and if they can produce that amount, then that amount out of their incomes is going to represent a significant investment for them. It may not be quite the same if somebody is earning $20,000, $30,000, or $40,000 a year, but we are talking now about people earning between $10,000 and $15,000 a year.

Senator CRANSTON. Mr. Zigas.

Mr. ZIGAS. Senator, just to comment on another aspect that we haven't spent a lot of time talking about—tax policy and its impact on housing—I know you have strong feelings about it.

I will just point out, in homeownership especially, I would urge the committee as it moves along to look at the implications of the 1986 Tax Act and the lowering of rates and its impact on the after tax cost of first-time homeownership, of which there is some increasing evidence has led to the average family and the average home having practically the same pretax and after-tax costs. The subsidy value of deductions that we have long assumed and paid for very substantially in homeownership seem now because of these changes to be less and less available to the first-time home owner. Especially as you look to a partnership with the Finance Committee on how to make a rational link between housing policy on the spending side and housing policy on the tax side, to look at ways in which we might use the tax system more efficiently to assist first-time home buyers.

As you know, we are spending over $50 billion on home owner deductions now for homeownership incentives. I am not questioning whether that is right or wrong. I am saying that there is evidence that increasingly that is not helping access to the first-time home owner.

It is not the crucial factor, but that may be an area, again, of looking at ways in which resources were already divided from homeownership and might be reconstrued so that they can help us get over this hurdle. All of the evidence is it is the first-year costs, the closing costs and downpayment, that are keeping many, many people out of the market in addition to long-term costs of maintaining the mortgage.

I just bring that to your attention because I think it is an area that you don't have direct jurisdiction on, but clearly it affects what you do here with these down payment and other problems.

Senator **Cranston**. Do all of you agree or does anybody disagree with Mr. Markus' view that the idea of trying to have for some specified period more of the monthly payment go into principal than interest would not work? Does anybody think there would be a way to make such a thing work?

Yes.

Mr. **Webdale**. A program that we are designing right now is sort of a variation on that idea, and that is that the family has sufficient income for homeownership except for the downpayment. The concept we are working on is that either a nonprofit or a governmental agency holds title to the property and there is, in effect, a lease purchase agreement put in to the deal so the family can afford to pay, say, a $1,000 a month. A certain amount of that is applied to a special escrow account, which will begin to grow. That would be applied to their downpayment when closing time does come in 3 to 5 years, depending upon how much the family can afford and the kind of mortgage they could carry.

With that idea, the family builds a downpayment fee and that is not the cost of the unit. They are paying the market cost of the unit, what they can afford, and if they don't go to closing, then the nonprofit or the governmental agency involved says that has been their rent for the unit for the 5 years.

So in a sense they do have a real pile of money on the downpayment side which they feel is theirs. If they do lose the house, then they would be losing what they feel is their equity in the house.

Senator **Cranston**. Any other comments on that point?

Yes.

Mr. **Eichler**. It is also possible if you could find some way to stretch out the time period for the down payment that the market forces may increase the value of the house enough so that that equity gap could be closed by secondary financing on the unit itself.

Senator **Cranston**. Any other comments on that particular point?

Terry?

Mr. **Duvernay**. Just a very short comment, to say that we support the committee's recommendation. What I would like to point to are two downpayment programs that we have started in Michigan that might allow us to look at this concept.

One is pointed toward very low income home buyers who are basically welfare recipients, where our authority will put in dollars that would allow, working with a nonprofit agency, the ability to get welfare recipients into the house on a lease basis and allow them to work with them as they build up the downpayment and also allow shelter payments that normally come from the Department of Social Service to go to debt service.

Over time then that nonprofit working with that family would have the downpayment accumulated and then with the loan to put them into homeownership.

It is a new program that has just started and I think will give us some information about how to make the downpayment work for some very, very low income families.

Also, for more moderate income situations, what we are trying to do is encourage people who want to buy homes, first-time home buyers, to save for the downpayment and have the State guarantee that the downpayment will be enough in the number of years they have selected to get into a house, enough to allow them to get in. The State basically guarantees the downpayment. But it is a savings program that allows individuals to save the downpayment necessary to do that.

In addition, the way I read the bill, part of what would help with the question of whether or not 3 percent is enough is to make sure that in building that homeownership program, especially where we deal with very low income home buyers, that we advantage ourselves on counseling programs and build in housing counseling programs to make sure that we work with the consent of the home buyer, to make sure that any problems they have can be corrected before they walk away.

Senator **Cranston**. There are a few specific questions we need your advice and thoughts on.

One, the HOME Corporation, let me ask several questions on that and any comments you have.

What do you feel would be the benefit of having a continually refined shelf of model programs States and localities could adopt, for example, for their own use? Which States are sophisticated enough to benefit from having the programs included on the shelf? Would less experienced States be helped by more sophisticated strategies? Would the private sector find it easier to negotiate new ways of providing, and would the Secretary find it easier to exercise leadership in housing policy?

Yes.

Mr. **Schwartz**. I think the answer to those questions is "yes." Having some clearinghouse of new programs and innovative programs that we share is, I think, critically important and folds outward into a general comment that is a technical assistance portion of this, of which I think this could be a part. I think it is going to be crucial.

A number—even the discussion of credit enhancement that was going on earlier—are not going to work in a lot of localities where literally even the city housing agencies may not have the expertise to take advantage of them. Frequently, there is no technical assistance provided. If you extend that outward to private developers, there may be three or four major developers in our city, which is a major city, that have a full and conversant understanding of this, and a lot of the small players just can't even get into it.

Similarly, the cross-fertilization between localities and States over things that are happening is crucial to getting decent ideas spread. So I think that is a very important function, underused right now. The capacity to share information, link up all of these things just is really not there.

I think this could be a very big improvement under this bill if this kind of an inventory were provided and some real workshops conducted throughout the country and maybe computer linkups nowadays, but a lot of us do have all that. I think all of that would be very helpful.

Senator **Cranston**. Any other comments?

Mr. **Lawson**. Senator, from the developer's, I would like to strongly support it. I think a standardized program or a series where your financiers, developers, and everybody is going to understand the program, that the cost of trying to make every deal a boutique kind of a process just will jeopardize the program and make many people not want to participate who otherwise would.

Mr. **Brendsel**. I would like to reinforce what has been said. We think that the capacity to share information in terms of the programs that work, the capacity for the secondary market, local lenders, borrowers, local housing authorities to work together is a very important one. That combined with the flexibility to choose one of the best which serves the individual's needs is very powerful.

Our own experience has been that you try some things, they work. You try some other things, they don't work. This is what we think is a very important leveraging part of this program.

Mr. **Sidor**. Senator, just really aiming at the statement, I would be remiss if I didn't say that the statement clearly strongly supports the idea of a HOME Corporation and particularly the models that it can do and the kinds of technical assistance it can provide. I think it is an extraordinarily good idea.

Senator **Cranston**. Great.

Ms. Moy.

Ms. **Moy**. I generally support the idea of the capacity development provision of technical assistance. I think it is very important that that assistance be provided by people that are truly knowledgeable in a nuts and bolts way with the programs.

There are many examples of networks across the country. The problem is that the person at that network cannot simply be a librarian who can log in programs. You know, you call up and you get a limited equity co-op program for a major city. That person has to be a knowledgeable technician at least, and I think if properly staffed it could be a very beneficial addition to the HOME Corporation.

Mr. **Dale**. I would agree with the comments that have been said. The one thing I would add is to be careful of its administration, that the few programs that somebody here in Washington sees and they particularly like don't become forced down every other agency in the country. I think it needs to be a communications device, not a way of essentially getting the Federal hand in and saying we will give you 10 points if you do it this way but we won't give you anything if you do anything new.

Mr. **Webdale**. I think that is a very important point that Mr. Dale makes. It is excellent to have models and share information, but at the same time what works in Fairfax may not work any place else because of the nature of the governmental structure and/or the marketplace that we are dealing in.

Second, on the training, to reiterate what was said, it is important that training be done by people who are really experienced and know how to do nuts and bolts. I know our organization Association of Local Housing Finance Agencies has been running training program with those kind of people. If you don't have nuts and bolts people, you are in big trouble.

Senator **Cranston**. Yes.

Mr. **Eichler**. I want to take a slightly different tack for a minute. I support the models, and I think to a certain extent a limitation on models that might be usable across the country can be important because more people will be familiar with the model and that does facilitate financing through the financing medium.

The other thing that we have yet found is people who are instrumental in putting these packages together at the government level occasionally protect themselves and protect the program because they are truly not familiar. What that does is drive the cost up.

So it is not just the models and their dissemination, but it is the ability to work with them properly.

Senator **Cranston**. Any other comments?

[No response.]

Senator **Cranston**. If not, let me move on to a matter of housing strategies.

The question is, what issues or concerns are raised by the bill related to the 5-year housing strategy? How do we ensure that those strategies will be realistic and workable rather than busy work? Are the right issues identified for including in the strategies and what potential problems may there be in the contents of the way those strategies are developed?

Mr. **Schwartz**. I am not going to tread in an area that I was advised was a delicate issue here, but this concerns the relationship between the HOP Corporation and the Community Development Block Grants.

Our office produces a 3-year housing strategy under the CDBG. That becomes the centerpiece of the allocation not only of block grant resources related to housing, but other resources—for example, the targeted rental rehabilitation that comes from the Federal Government and State weatherization money gets factored into it, and that becomes the linchpin.

This bill's mention of a strategy sounds like that process, which is fine. We also, of course, have to submit an annual block grant application, which in our city is very heavily oriented to housing, since that is the overwhelming crisis that seems to have no other basis of support right now.

I guess I have no problem with the strategy. What I would have is a problem with having to do one housing strategy for this program to another housing strategy under somewhat different auspices for the Community Development Block Grant program. It does seem to me that we have to find some way in cities, particularly where CDBG funds are used heavily for housing and will still need to be even after this program, that that process of developing a strategy can be done mutually so that we don't end up with a stumbling over.

We have a new program now that, in effect, ends up doing exactly the opposite to what it intends; namely, complicating our administrative requirements rather than simplifying them.

Senator CRANSTON. It is plain that the housing strategy would incorporate and substitute for the CDBG.

Mr. SCHWARTZ. That wasn't clear from the written material here. I think, then, that is fairly important because it does force us to think ahead, to plan our resources carefully, and to create some standards of accountability, and frankly I think that even going back to the very first dialog between Michigan and Philadelphia here, my only point is that even though we get hoisted on our petard there has to be some accountability for whatever money we do receive, and the strategy becomes a way of creating a framework for that accountability.

Mr. RUBENZAHL. I only have one thing to add.

There is a provision in here that gives the HUD Secretary a fair amount of discretion, and while I support the notion of having the strategy prepared, basically everything that has been said, I really strongly oppose the notion of the HUD Secretary having discretion in terms of approving or disapproving on some arbitrary basis.

A number of people who I work with found out that I was coming here, and I got all sorts of calls saying this is a serious problem. There are communities that are proceeding to develop housing and maintain affordable housing in their own ways, and it is inappropriate for the HUD Secretary, with various biases that they may have, to overrule local government and say, no, your strategy is inappropriate because of the public policy that you have rather than a factual statement that you have made in terms of the use of the money or the program that you are proposing to use the HOP money for.

So I would strongly propose that you take that provision out.

Senator CRANSTON. Mr. Lawson.

Mr. LAWSON. Senator, I think it would be very important that the housing strategies address regulatory reform in areas and in different communities where that would impact the cost of providing housing or where in fact the community may have created its own affordable housing problem.

Mr. RUBENZAHL. If I might just say it right on the table, rent control is really the issue here. There are communities that believe that rent control is of benefit to low income people, and there are studies all over the place that say that is true. Then there are studies that say it is not true.

For my 2 cents, it is not up to HUD to decide who is right and who is wrong on this issue. It is a local issue, and the locals ought to decide. That is why I am opposed to this provision.

Mr. LAWSON. We will just have to disagree.

Senator CRANSTON. Let me say that we don't propose to have a provision that would shut off rent controlled areas. We will make that plain in the bill as far as I am concerned. We have been working with the Senator Robertits [California Senator] office in coming to an agreement on that.

Mr. **Zigas**. I fully support comprehensive plans for the use of this money, and the outlines you have here are very good. There are a couple of areas that could stand some improvements.

Section 10 refers to a certification that the jurisdiction will affirmatively promote fair housing. I would say that you have to have a substantially expanded requirement there. There should be a requirement to outline what in fact they plan to do to ensure that opportunities are available for all economic and racial groups in the community.

I think also there is no real mention here of numerical goals, given our needs. What is the plan? Perhaps I missed it in translation, but I think it is very important for HUD, for citizen review and for outside review, to try to say, well, is this thing working or isn't it, to really have goals that are set by the jurisdiction and against which they can be held accountable down the road, and I think the HAP plans used to require that, assess your need and then you have a numerical goal about how to meet it, and it would be roughly analogous to the needs you identified.

So, for instance, if you identified large family housing as the most critical need and you have built nothing but elderly efficiencies, then HUD can reasonably hold up your block grant and say, you know, you are just not using these funds to address these needs.

The other point I would make is that for some communities I think we have to acknowledge, and especially if we go on the formula basis, there are some communities who will voluntarily refuse to participate in this program because all they are going to lose is money to do things they don't want to do in the first place, and I strongly urge you to think of ways of tying other grant funds to the use of funds that are made available on an entitlement basis by these communities, and failure to do so will mean more than you just don't get something you don't already have. It will mean you could jeopardize access to a lot of other development-oriented funds which you think you have as a matter of right.

Senator **Cranston**. How about suggesting some ways?

Mr. **Zigas**. Water and sewer grants, highway money. There's plenty of forms of Federal money that communities have access to.

If we are serious about this, if we are going to entitle communities to housing funds, there are funds that can be made contingent upon successful completion of these plans.

Senator **Cranston**. Speaking of block grants, they are effective.

Mr. **Zigas**. I think that is the least part of it. Clearly, it is important, but there are other sources of money that I think would enhance the desirability of filing plans and completing them in a timely manner.

Mr. **Sidor**. I think the notion of using the plan or the strategy as a way of getting at accountability is a very good one. I also think that with perhaps some fine-tuning we could use the strategy development as a way to engender full cooperation between State governments and local governments.

There ought to be an opportunity, and as a representative of State agencies, I am not saying have State approval of all the strategies, by any means, but I think there ought to be some period of time where the State and local governments can negotiate and discuss their preliminary strategies before they are submitted to Washington and use that opportunity to really exchange points of views, objectives, different approaches to solving these issues and not repeat some of the mistakes that were made with the McKinney program where each jurisdiction did their thing and they were never seen or discussed among one another.

Mr. DUVERNAY. I would like to quickly echo what John said. That was my very point, too.

I think it would go a long way to get us away from the question of State/local cooperation if at the very beginning on plans that locals and States work together to decide how best to meet the housing need of that State and how best to allocate resources between them and make it cooperation rather than an enforcement mechanism.

Senator CRANSTON. I would like to get to the HOP program briefly and talk again about the matching requirements.

Are the State and local matching requirements properly drawn, in your opinion? What types of contributions should be counted? Are they too difficult for many jurisdictions to meet, and how could the matching requirements be refined?

Mr. WEBDALE.

Mr. SCHWARTZ. I think they are going to be tough in many areas. I know we are in an enormous fiscal crisis in the city. I understand a number of States are, and given that the people that this bill is supposed to help are people who don't necessarily have a lot of political power, it becomes something that many localities and even some States might sacrifice.

I think the proposal for tax abatements being included is one that I would support. I think the degree to which in-kind contributions of one sort or another can be factored in would make it a lot easier, even some targeting of services ordinarily provided, but perhaps provided more intensely to these kinds of projects in these areas.

I don't know what language you would need there, but I am saying that this gets to be difficult, and we have had some real problems in even the local matches on some of the homeless funds and some other funds here, given the fiscal crisis that our municipality has experienced.

Mr. RUBENZAHL. I would echo that. It is really a mistake to require all communities to provide match. What I would suggest is that we really have no match or a very minor one for the entitlement funds. For the incentive funds that may be a more appropriate place to require a match of the size that you laid out in the bill.

Mr. ZIGAS. I would like to add to that. You know, the housing task force recommended a similar break in the reallocation provisions, and here you could also match one of the priorities that reallocated money, bonus money, goes to. We have worked with many of our constituents, and they live in communities that are always looking for excuses for why they shouldn't take Federal money. Match is one of the easiest to cite, and we are very concerned that the communities who most need this money would be the ones who would be the first to turn it down.

Mr. **Sidor**. From a State perspective, at least from our perspective, Senator, given the fact that you do have some provisions to allow waiver of the match over a period of time, if indeed the tax side can be counted as part of the match, if indeed the States working with localities that are not presently in the jurisdictions that can be brought to the match table, I think by and large States would have too much difficulty with the way it is crafted right now.

Senator **Cranston**. Do you have any thoughts on how we make sure States and localities use open and fair procedures for awarding HOP funds? Specifically, how do we avoid having, committing, or allowing any State or local officials to engage in the kind of activities that characterized the Reagan administration's section 8 Mod Rehab program?

Mr. **Zigas**. Senator, I would urge, as I mentioned earlier, I think one of the principal things that would be advisable is to greatly expand the specifications for citizen participation in the development of plans and in the development of public access to records that are provided.

The citizen participation section in here is brief. I think our experience with Community Development Block Grants shows that the more specific you can be about the points in the process at which public intervention has to be made available, it is important from a public policy point of view, but also from the point of view you are raising. At some point procedures have to be open to public scrutiny. It is a lot tougher for the kind of process that we have seen unveiled in the IG report to go on for any length of time. There are simply too many people who will bring it to public attention.

Mr. **Webdale**. I think that is a very important point. The public scrutiny at the local level should be built in. There has to be not only a good plan, but public forums at which that plan is presented and people have an opportunity to comment and ask questions.

Mr. **Schwartz**. The other point I would make concerns the potential simplicity and accessibility of the program. The Reagan corruption thrived on programs that were complicated to understand, that a major developer needed expert knowledge and a smaller developer would not. There were resources available here in the end to those who could get here and had political ties.

To the degree that at the local level you create programs that are simpler, wider access to participation, and therefore greater pressure on a local agency like mine to put things out to competitive bid, requirements for competitive bidding, and making access available on that basis with citizen participation, I think that limits it, and where those kind of requirements are in effect corruption cannot go on too long without its being discovered and attacked.

Mr. **Lawson**. Certainly, the competitive bidding process. Make sure it is open is the best way.

Again, we strongly support the simplicity aspect.

Senator **Cranston**. Are the eligible uses of HOP money properly drawn in the bill? Does it make sense to try to encourage rehab as a preferred choice over new construction, and should we give any preference to rental property over homeownership, which would be going in the opposite direction?

Mr. **Webdale**. It all depends on the community. Is this going to be flexible? In my community, rehab is going to be a very minor component. In yours, it is going to be a major component.

Mr. **Zigas**. Public input in these plans is one of the things you are going to have to really emphasize in order to get a product that is responsive. It is entirely possible that you can meet tremendous rehab needs, which is good for its own reasons, or you can move on to a high level of new construction because hypothetically some chief executives prefer ribbon cuttings to rehab. If you have a public planning process where people are able to come in and say, well, this plan is totally unresponsive to the realities of our housing market, you do guard against that, and I certainly support Walter's point that this is going to vary across the country.

Mr. **Lawson**. To argue an extreme, I think there is no cost control in the program, and that does bother me. One could build a $200,000 house and rent it for $25 a month. And I think if somehow through the incentive process or something else there was a measurement as to cost effectiveness, that supported and measured how the cities were doing it, it would be some stop.

Senator **Cranston**. Yes.

Ms. **Moy**. To bring in the private sector participation, again, I think the uses are very flexible, and I think that is good. The investments that are permitted seem to range from equity investments to interest bearing and noninterest bearing loans, including first mortgages. That is both good and bad. It gives you a lot of flexibility, but it doesn't necessarily encourage the locality to bring in private sector money, which is where they would typically come in on the first mortgage side.

Perhaps there should be some incentives built in to guarantee that as frequently as possible, that a private lender be involved in the project.

Mr. **Schwartz**. I think that the question that ought to be focused carefully to bridge is the people who benefit in a locality as opposed to the buildings themselves. That sounds so obvious, but I am in the midst right now of a fight with our regional office, which is about to really get quite strenuous because I am going to make it strenuous, where their standard of efficiency relates to the amount of money spent as opposed to the number of people benefited—without going into the details, at least of certain conclusions, in my view, on their part—so that the bridge as to whether we do rehab or new construction should be how many people would benefit as the result of moving in one or another direction, given the costs of one or another activity in a particular locality.

If that is spelled out very clearly somewhere in the legislation, I think that is a way of bridging this.

Senator **Cranston**. Let me move on to one other aspect that was not specifically in the housing bill, but the National Affordable Housing Act has, as you know, garnered a lot of support in the Senate. We now have 40 cosponsors, a strong majority of the parent Banking Committee, to revitalize our national housing policy. However, it will take more than passing an authorizing bill, as tough as that alone will be. I expect to get this through this Senate this year and get a bill through the House next year.

How do we mobilize nationwide support for all phases—authorization, budget, appropriation, and tax policy? Do any of you have any suggestions of anything we should be doing to make sure we get the full support beyond the obvious things that are now being done?

Mr. Schwartz. I think again from the local level, NCDA supplied us with very good information from here. At the appropriate moments, we are in the position not only to mobilize our own public employees, but many of the constituents of the programs as this moves down the road and it is needed.

If you let us know, we will use the same resources that we have been using for national community development, which has been growing every year. We get quite a lot of mail. I think we generated a lot of mail here last year when we were threatened with additional CDBG cutbacks. That seemed to have some effect, and we have pretty good partnerships, with occasional disagreements, with the National Low Income Housing Coalition.

So I think just keep the information coming and let us know where and when we are needed, who needs to be contacted.

Mr. Duvernay. Not to be too cute about it, I would say keep doing what you are doing. This has been, I think, from the start of the idea through this point one of the most inclusive processes that I have known. What it has allowed us to do in either the associations we are involved in or within our States is to build a network of people who are concerned that housing again be on the front burner, and I can tell you that they are either through those associational contacts or through people who are either in the industry, from low income housing advocates to home builders in my state that have formed a network of wanting to know what it is that they can do more to make sure that what you are doing works.

So keep doing what you are doing, I think.

Senator Cranston. We will try. Thank you.

Barry?

Mr. Zigas. I couldn't agree with Terry more. I would add one more dimension based on our conversations with grass roots organizations around the country.

I think the kind of leadership you and Senator D'Amato have shown on putting together a structure for revitalizing housing assistance has been greatly appreciated. It has taken an enormous amount of effort. I think the challenge is next helping provide leadership to people in the field around the issue of money.

When we discuss this bill—and you and I have discussed it before with people around the country—the first question they ask is, but is it going to be enough to make a difference in my community? And I would see that the task all of us have together is to focus on that question and say as effective a leader as you have been on moving forward the structure, I think the next step is for all of us to join together and really zero in on providing the resources necessary for this, and I think this fall when many of us are planning a demonstration of popular support for housing here in Washington, I think that provides the perfect opportunity to move in that direction, and I hope we can all do that together.

Senator **Cranston**. I will count on all of you doing that.

Yes.

Mr. **Eichler**. I would just like to add that there seems to be a much stronger and growing awareness in this country of the need for housing at all levels except a very high level, and I think it is important to capitalize on that requirement for moderate on down in the papers in any way that is possible because I think the support of the people will help a great deal in getting these programs through. There is no question about the fact there are a lot of people out there that can't find a place to live.

Senator **Cranston**. We have proceeded in an unusual way this morning. I want to do one more unusual thing before we quit. We have got to quit at 12:30. So there will be a limit on how long this goes on.

But a lot of you have been sitting around this room beyond the table very patiently all morning, and if any of you feel that we have totally overlooked something or we are totally headed in the wrong direction or if you have a question you would like to address to anybody here, now is your chance.

Mr. **Zigas**. It is kind of like a wedding. [Laughter.]

Senator **Cranston**. Yes, speak now or forever hold your peace.

Stone silence. [Laughter.]

I do want to thank all of you, the panelists and all of the others who were present.

One more question. Do you all feel this is a good way to proceed, and do any of you have any suggestions as to any ways to improve this process?

Yes.

Mr. **Hays**. I walk away from this meeting with the impression that this is the first time in my almost 20 years involved in the mortgage markets that we may have a national housing program that has some potential to operate with real efficiency as opposing to losing a tremendous amount of efficiency in the way of structure.

Second—I think I am speaking for the other people here—that our time was well-used today and that you truly understand our viewpoints. I realize the limitations of this format as far as you are concerned, and I am delighted you used it and urge you to continue it.

Thank you.

Senator **Cranston**. Thank you.

Yes?

Mr. **Schwartz**. I want to echo that and just add one other area of ongoing dialog, and that is simply a careful discussion—and I look at this more carefully, for some of us who administer at the local level and at the State level—on, you know, what our perception of the real impact of differing procedures would be on administrative problems at the local level, and particularly with a block grant and maybe a couple of other things that will survive this, so that we can try to avoid some of the things legislatively that I see plaguing us in the other programs at this point.

Senator **Cranston**. Yes?

Mr. **Rubenzahl**. I would like to raise one issue. I just realized it hasn't been brought up, and that is the rent formula in the bill is, I think, weird. The way I calculated it, the rent for a four-bedroom unit—qualified rent for a four-bedroom unit is twice the rent for a two-bedroom unit. I think that is inappropriate.

The tax credit provisions where rents are based on family size, while it causes some problems for developers, basically not knowing what the rent would be, the uncertainty of family size in the kind of units occupied, it does provide an incentive for developers to rent to larger families than they might otherwise try to rent to.

I think that has worked very well in providing housing for extremely large families or very large families, and I would encourage you to have similar kinds of rent provisions in this bill.

Maybe I at the same time should raise the whole question of this notion of qualified rent being fair market rent. It seems completely inappropriate to me. The rents ought to be affordable, as I said earlier, in my opinion, to at least half the units to people at 30 percent of median and three-quarters median to 50 percent. I think that just needs a little bit more work, and I will be happy to provide some written comments here to work with you about that.

Mr. **Zigas**. I second those comments.

Mr. **Lasko**. The format is wonderful and allows these last minute thoughts to be tossed in.

I just want to say, I think for this one-stop service concept to work, for the HOME Corporation to do what you want it to do, it is very important where in HUD it is placed. I would urge that to the extent you can exert your own influence to see that it is placed within the Office of Housing, that is going to make an enormous amount of difference.

The HOME Corporation has to have authority as well as responsibility, and the people running it have to have some influence over section 8 monies, over the McKinney Act moneys, over FHA, and if it is going to be able to be indeed a one-stop service, housing czar type office, it really ought to be where the money and resources are, in the Office of Housing.

Thanks.

Mr. **Sidor**. I applaud the concept and the way you have handled this from the very beginning. It is extraordinary. I hope it spreads to other committees and other chambers.

Senator **Cranston**. I hope it will, too. [Laughter.]

We are going to have a number of additional hearings, and I wanted to let you all know that on July 18 Secretary Kemp will be our witness. So then we will learn the administration point of view, which may not have a deadline to meet. I don't know if they have figured out their stance.

The next hearing is Friday morning on homeownership. I thank all of you and the panel very, very much. I think we had a very productive session, and I thank all of the others who were present.

Thank you.

[Whereupon, at 12:30 p.m., the committee was adjourned.]

[Prepared statements of witnesses follow:]

STATEMENT OF BRIAN HAYS
CHAIRMAN, PUBLIC SECURITIES ASSOCIATION
BEFORE THE
SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
SUBCOMMITTEE ON HOUSING

ROUNDTABLE ON THE CRANSTON-D'AMATO HOUSING BILL

JUNE 7, 1989

Good morning. My name is Brian Hays. I am the Chairman of the Public Securities Association (PSA) and Senior Vice President at Drexel Burnham Lambert Incorporated. I am speaking on behalf of the PSA, which is the international trade organization of brokerage firms and banks dealing in mortgage-backed securities, U.S. government and federal agency securities, municipal securities, and money market securities.

Mr. Chairman, it is a pleasure to appear before you today to discuss the Cranston-D'Amato bill, and in particular, Title III, which creates the HOME Corporation in the Department of Housing and Urban Development. I would like to take this opportunity to commend you, as well as Senator D'Amato and the other co-sponsors of this legislation, for your bipartisan effort to make the provision of affordable housing a high priority for the federal government.

The nation faces serious housing problems. Owning a home remains a primary goal of most American families, yet statistics show that homeownership is becoming increasingly more difficult for first-time homebuyers. Young people often find themselves priced out of the housing market. In fact, for the first time since the Depression, the rate of homeownership has begun to decline.

Affordable rental housing is also in short supply in many areas of the country. Production of rental housing has declined as a result of the serious reduction of federal funds over the last eight years as well as the major changes in tax law made by the Tax Reform Act of 1986. The nation certainly needs an imaginative federal housing initiative. S. 565 is a laudable effort to reinvigorate federal housing policy by continuing programs that have worked well in the past and by creating new programs to address unresolved problems in the provision of affordable housing.

I will focus my remarks on Title III of S. 565, which creates the HOME Corporation to help stimulate private investment in affordable housing. Before doing so, however, let me mention two specific provisions in the bill that PSA strongly supports. These provisions extend the Mortgage Revenue Bond program, now set to expire at the end of 1989, to 1992, and make permanent the low-income housing tax credit. The Mortgage Revenue Bond Program has been an invaluable tool for state and local governments to provide opportunies for first-time home buyers with low-to-moderate incomes. The low-income housing tax credit, though it has some limitations, has also been useful in the promotion of low-income housing. PSA ultimately hopes that both programs will become permanent features of the nation's housing policy. In addition, PSA supports the proposals made by the Mitchell-Danforth Task Force to remove the penalties in the low-income housing tax credit associated with using tax-exempt finance.

I would now like to direct my testimony to the investment strategy discussed in Title III of the Cranston-D'Amato bill.

Options for Federal Assistance for Targeted Housing Programs

As the Subcommittee is well aware, the basic problem that the HOME Corporation will face is that low-income rental housing and low-to-moderate income single-family housing is usually not economically feasible without government assistance. With respect to rental housing, low-income tenants cannot afford the rents necessary to make low-income rental housing developments profitable for private investors. In addition, mortgage lenders, aware of the risk involved in low-income housing, charge developers relatively high interest rates on loans to finance low-income housing developments. With respect to targeted single-family housing, moderate-income families often cannot find any home within their means.

Faced with this problem, the government has two options. It can provide direct subsidies or it can assume credit risk. To stimulate investment in multi-family housing, the government can provide rental assistance to tenants or tax credits to developers or it can guarantee mortgage loans taken by developers, either individually or in pools. To stimulate investment in low-to-moderate income single-family housing, the government can subsidize downpayments, mortgage payments, or can guarantee mortgage loans taken by low-to-moderate income families.

In employing these options, the federal government faces two basic problems. The first is that credit enhancement, i.e., government guarantees of mortgage loans, may not be sufficient to stimulate investment in low-income housing without additional direct federal subsidies. In other words, credit enhancement may not obviate the need for direct budget outlays. The second problem is that the government, if it chooses to provide credit enhancement, may face some tension between protecting itself from credit risk through sound underwriting standards or fees and making housing programs available to low-income families. These problems are discussed below.

The Need for Subsidies to Stimulate Low-Income Housing

Credit enhancement in the form of a federal guarantee of some link of the mortgage lending chain can play an important role in the provision of low-income housing. Credit enhancement alone, however, may not be sufficient to make low-income projects economically feasible.

State and local governments are currently able to borrow at tax-exempt rates and pass on their cheaper cost of borrowing to low-income developers, through the issuance of qualified residential rental private-activity bonds, and to first-time homebuyers, through the issuance of mortgage revenue bonds. A federal government guarantee along the lines envisioned by S. 565 could, at best, lower the cost of credit to low-income developers or to homebuyers to somewhere close to the yield on GNMA securities, which is considerably higher than the yield on tax-exempt securities. Presumably, any security guaranteed by the HOME Corporation would not be exempt from taxes. In the past, Congress has rejected efforts to combine federal guarantees with tax-exemption for a variety of reasons.

Even with a very low cost of borrowing, state and local governments have to work hard to make their housing programs economically feasible. Indeed, the volume of tax-exempt bonds issued for multi-family housing has fallen off over the last several years. Some market analysts are concerned that the elimination of certain real estate provisions in the Tax Reform Act of 1986 and the increased targeting required by the Act will make multi-family housing economically impossible for many developers, even with a tax-exempt borrowing rate.

Since the targeting for low-income housing projects financed with state or local tax-exempt bonds is similar to the targeting required by S. 565 (in fact, S. 565 requires stricter targeting for single-family housing), we can perhaps use the state and local experience as a benchmark for the minimum amount of federal assistance required to make low-income housing economically feasible. A government guarantee by itself would not provide the same level of assistance as a tax-exempt bond issued by a state or local government. Hence, a federal guarantee by itself might not be enough to stimulate the development of low-income housing. Direct federal subsidies might also be required.

Government Credit Enhancements

While government credit enchancement alone may not be sufficient to stimulate investment in low-income housing, government guarantees can certainly play an important role. A federal government guarantee could substantially lower the cost of borrowing faced by developers and prospective homebuyers in the private market.

Provision of a federal guarantee requires the government to take on some of the credit risk involved in low-income housing. S. 565 allows the HOME Corporation to charge fees for its guarantees or to impose underwriting standards similar to those used in private industry or in government-sponsored agencies. If these fees are high enough, or if the underwriting standards are sound enough, to fully protect the federal government's credit exposure, they may make low-income multi-family housing economically impossible for developers or affordable single-family housing impossible for prospective homebuyers of moderate income. In other words, there may be some tension between reducing the credit exposure of the federal government and providing necessary subsidies for low-income housing.

In general, it seems that the best course to follow is to use sound underwriting standards, rather than fees, and to subsidize the underlying projects to the extent necessary to make them economically possible. Use of unsound underwriting practices exposes the government to potential losses in the future, even if fees are charged. In addition, the use of fees increases the initial cost of housing, discouraging its production. The use of sound underwriting standards, however, requires federal subsidies to allow housing projects to meet these standards. This may limit the amount of housing that the HOME Corporation can generate. In this respect, there may be some tradeoff between the soundness of the program, and the provision of as much affordable housing as possible.

With respect to the administration of the HOME program, the use of fees could create an additional problem. Depending on how mortgages guaranteed by HOME are securitized, mortgages could be charged multiple fees. For example, if GNMA were to issue securities backed by HOME mortgage pools, the mortgages would be assessed two fees, one by HOME and one by GNMA. This would increase the cost of the program for developers and prospective homebuyers.

Creating a Secondary Market in Affordable Housing

As presently drafted, S. 565 seems to envision the creation of a secondary market on pools of mortgages on affordable housing guaranteed by the HOME Corporation. The legislative language allows HOME to guarantee obligations issued by GNMA, FNMA, FHLMC, state and local housing agencies, and qualifying private financial institutions if the obligations are backed by pools of mortgages in affordable housing. A successful secondary market along these lines could help to lower borrowing rates for mortgages on affordable housing in two ways. First, and most important, the government guarantee would ensure the safety of securities guaranteed by HOME and lower the yield investors would require on these securities. In addition, an active secondary market for these securities could make them more liquid, hence more attractive, and therefore lower the yield still further.

Reducing borrowing costs with a government guarantee is easy, although the government must decide how much risk it is willing to bear, as described in the section above. Developing a liquid secondary market is more difficult. Basically, it will require sufficient volume of securities and sufficient standardization. Standardization of securities allows for rapid and relatively inexpensive trading; volume ensures that a ready market will exist for such trading.

Applying these two criteria to securities envisioned in S. 565, it seems likely that the overall volume of securities generated will be limited by budget constraints, which will prevent the federal government from making large direct outlays to subsidize low income housing. Moreover, this volume will be divided into at least two types of securities -- those backed by multi-family mortgages and those backed by single-family mortgages. If different types of securities are issued by state and local housing agencies and federally-sponsored corporations, the volume will be further divided. In order to gain the maximum benefit from the secondary market, the basic structure of the securities issued by the various agencies will have to be standardized. In this respect, there may be some tension between allowing flexibility in the administration of the HOME program and making a secondary market work effectively.

Finally, even though these securities would be guaranteed by the HOME corporation, investors could face some risk of delayed interest or principal payments in the event of a default or foreclosure. Sound underwriting standards on the mortgages underlying the securities would make default or foreclosure less likely, and reduce any uncertainty associated with holding securities guaranteed by the HOME Corporation. This supports the earlier point that the use of sound underwriting standards and direct federal subsidies to help low-income individuals meet the standards is the most effective way to administer the program.

Conclusion

The Cranston-D'Amato bill is an exciting development in national housing policy. PSA strongly supports the initiative and will be happy to provide advice in the development of credit enchancements for affordable housing. The task will be difficult, however, because affordable housing is often not economically feasible and thus requires extensive federal assistance. Budget constraints may limit the extent of this assistance, and thus, in turn, limit the volume of securities guaranteed by HOME that can be delivered to the secondary market.

We hope the questions we have raised will stimulate fruitful discussion and help to produce a workable and effective program for the HOME Corporation. We look forward to working with you in developing this legislation to provide affordable housing for our nation.

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Mortgage Bankers Association of America

STATEMENT OF

WARREN LASKO
EXECUTIVE VICE PRESIDENT
MORTGAGE BANKERS ASSOCIATION OF AMERICA

before the

SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS

OF THE

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

UNITED STATES SENATE

Roundtable Hearing
on

The HOME Corporation
Authorized by Title III: Investment in Affordable Housing
of S 565: "The National Affordable Housing Act"

June 7, 1989

We are pleased to be included in the roundtable discussion concerning the proposed HOME Corporation. We applaud efforts to streamline and improve access to the capital markets by state and local government housing finance facilities. The Federal government, through HUD and its programs, has and continues to serve an essential role in channeling funds to the housing markets. Providing a one-stop service "desk" at HUD for state and local housing assistance initiatives is a worthwhile goal that has potential for more effectively allocating and delivering increasingly scarce federal financial resources for housing.

MBA estimates that mortgage banking firms across the country facilitated financing of approximately 90-95% of the privately owned low and moderate income housing produced over the past 20 years. This was achieved largely through mortgage bankers' access to the capital markets resulting from the creation of the Federal secondary mortgage market programs of the Government National Mortgage Association (GNMA), the Federal National Mortgage Association (FNMA), and the Federal Home Loan

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*The Mortgage Bankers Association of America is a nationwide organization devoted exclusively to the field of housing and other real estate finance. MBA's membership comprises mortgage originators and servicers, as well as investors, and a wide variety of mortgage industry-related firms. Mortgage banking firms, which make up the largest portion of the total membership engage directly in originating, selling, and servicing real estate investment portfolios. Members of MBA include:

- Mortgage Banking Companies
- Commercial Banks
- Mutual Savings Banks
- Savings and Loan Associations
- Mortgage Insurance Companies
- Life Insurance Companies
- Mortgage Brokers
- Title Companies
- State Housing Agencies
- Investment Bankers
- Real Estate Investment Trusts

MBA headquarters is located at 1125 15th Street, N.W., Washington, D.C. 20005; telephone: (202) 861-6500.

Mortgage Corporation (FHLMC), coupled in many instances with FHA insurance on the underlying mortgages.

Consequently, we believe we may best assist the Subcommittee by highlighting some of the positive features of these firms and programs, particularly GNMA, which may serve as a model for the proposed organization of the HOME corporation. This statement focuses on two of the questions listed as suggested issues on the Subcommittee's May 18 Questionnaire: the development of a secondary market for state and local lending instruments and refinement of the credit enhancement window.

The HOME Corporation's guaranty will undoubtedly help assure the marketability of mortgages on low and moderate income housing at reasonable interest rates. However, the corporation will need to build on the experience of GNMA, FNMA, and FHLMC to assure the integrity of the underlying mortgages, projects, and sponsors, if it is to avoid undue risk and losses to the Federal government.

SUBTITLE A: HOP MODEL PROGRAMS

We note that the HOME Corporation "in cooperation with ... government-sponsored mortgage finance agencies..., and the private sector is directed to develop a selection of model programs to maximize resources for housing."

Much of the $6 billion authorized by Title III will fund HOME Corporation model programs. Title III funds according to Section 311(b) can be used for a wide variety of types of projects such as equity investments, and interest bearing and non interest bearing loans. We understand the desire for flexibility, given the wide variety of local housing needs. Some jurisdictions may consequently find that grants are the most efficient means of delivering affordable housing. In contrast, other jurisdictions may choose to loan these funds so that the funds may be recouped later and used for other projects. To the extent that localities use their HOP funds for loans, we urge that flexibility be balanced against the need for program simplicity and the goal of facilitating a strong market for the securities that will be created under the auspices of the HOME Corporation.

We note from the GNMA experience that substantial efficiency and cost savings result from creating uniform mortgage obligations which form the base and backing for securities that are homogenous and recognized by the market. The Federal Housing Administration (FHA) mortgage insurance and coinsurance programs have assured a market for single-family and multifamily mortgages in good times as well as bad. The features of the underlying debt obligations on both types of mortgages are standardized and homogeneous. Standardizing products makes it easier to generate a large volume of mortgages and resulting mortgage-backed securities acceptable to the investment community. High volume is needed in order to generate the liquidity investors desire. GNMA has been successful in large part because its program is straight forward and standardized. The full faith and credit Federal government guaranty of the timely payment of principal and interest has wide investor appeal.

Standardization and investor appeal currently are lacking in most state and local housing finance instruments. It is not clear that the legislative proposal places enough emphasis on these necessary conditions for the development of a secondary market. The Act could benefit from clarification on two points: (a) that it is not necessary to duplicate the programs already provided by FNMA and FHLMC, and (b) that the mortgages and securities instruments should be as straight forward and homogeneous as practical, without unduly restricting efforts to develop innovative instruments acceptable to the capital markets.

Initially, the HOME Corporation program should guarantee or provide credit enhancement for debt instruments with reasonably standard payment features which the resulting securities mirror. Even if features are not standard, they should be such that securitization can be accomplished easily. In addition, it would be advisable to minimize the extent to which government personnel is needed to process transactions.

Mortgage bankers and other private lenders have traditionally originated and securitized most low and moderate income mortgages, serving an integral role in the mortgage finance delivery system. Historically, these mortgages have been primarily federally insured mortgages, although state and local initiatives have recently begun to bear fruit. We hope that the Subcommittee will more clearly articulate the role anticipated for private mortgage lenders within the HOME Corporation concept.

SUBTITLE B: MORTGAGE CREDIT ENHANCEMENT

Section 331 of Subtitle B authorizes The HOME Corporation "...to guarantee and to make commitments to guarantee obligations that (1) are issued by state or local housing finance agencies, corporations owned or chartered by the United States, (presumably GNMA, FHLMC, FNMA and the Federal Agriculture Credit Corporation), and financial institutions approved by the HOME Corporation, and (2) are backed by pools or trusts of mortgages on affordable housing, or by participations in mortgages on affordable housing..." (emphasis added). As noted earlier, mortgage companies have substantial experience originating, pooling and servicing both single-family and multifamily mortgages. We hope we are correct in understanding that it is anticipated they will be included among the "financial institutions" approved to participate in HOME Corporation programs.

The HOME Corporation's guaranty authority cited above, is similar to GNMA's. It nonetheless seems likely that substantial differences will arise in the HOME Corporation's operations compared with GNMA's.

Because the HOME corporation will offer a full faith and credit guarantee, presumably of timely payment of principal and interest on new mortgage pools or participation certificates, it will be at substantial risk. While under Section 335, the HOME Corporation can seek to minimize its risk of loss through such arrangements as insurance or guarantees by others, it will probably have to review each pool of mortgages carefully. The HOME Corporation may consequently have to develop an underwriting capability and will require a competent and experienced staff.

GNMA, on the other hand, takes very limited risk--it acts as a guarantor, not as an insurer. In its most successful programs, GNMA faces essentially no credit risk on the underlying mortgages. GNMA merely guarantees timely payment of principal and interest on securities, while the default risk on the mortgages is borne by insurance or guarantees issued by the FHA or the Veteran's Administration. The credit enhancement provisions authorized in Subtitle B are designed to be fairly self-supporting, so the guarantee fees charged by the HOME Corporation to compensate for the risk of loss could be very high in comparison to those charged by GNMA.

In addition, the HOME corporation is directed, as prescribed in Section 334, to confine itself, "insofar as practicable, to residential mortgages... of such quality, type and class as to meet generally the purchase standards imposed by private institutional mortgage investors or government-sponsored mortgage finance agencies." If it restricts itself to only "investment quality mortgages" or requires substantial insurance on the mortgages, the HOME Corporation role may merely duplicate existing programs and products channelled through existing secondary market entities.

We suggest it would, further, be helpful to clarify whether the HOME Corporation itself would pool mortgages or rather that other entities would do the pooling. We suggest the latter approach, which has allowed GNMA to maintain a small staff and operate both efficiently and effectively.

One of the reasons, GNMA has been extremely successful is that it has learned to operate with a lean staff with most operations delegated to private firms. Private lenders make and service loans, pool them, and issue and distribute the securities. Chemical Bank has served for many years as the GNMA transfer agent, and more recently as a pool processing agent. A similar arrangement might benefit the HOME Corporation.

MBA hopes that these comments help the Committee in considering refinements to the HOME Corporation. We welcome the opportunity to participate in the roundtable discussion. We continue our strong support of the work that the Committee has done so far in such an important cause. We look forward to working with the Subcommittee and will be happy to respond to further questions or, if necessary, provide additional assistance.

Terrence R. Duvernay
Executive Director, Michigan State Housing Development Authority on behalf of the
National Council of State Housing Agencies

Presentation on the HOME Corporation- Housing Opportunities Partnership Provisions of the National Affordable Housing Act

Before the Housing and Urban Affairs Subcommittee
of the Senate Committee on Banking
Housing and Urban Affairs
June 7, 1989

During the last decade, states have assumed a more prominent role in the design and delivery of affordable housing programs. At the forefront of this effort are the 58 state housing finance agencies (HFAs). Among the state HFAs -- many of which have been active for more than two decades -- over 350 housing programs ranging from homeownership to special needs housing are operating.

All of the 58 state HFAs are members of the National Council of State Housing Agencies (NCSHA), a national, not-for-profit organization created in 1970 to take a leading role in national housing policy discussions in the area of low and moderate income housing. It is on behalf of the Michigan State Housing Development Authority and NCSHA that I appear before you today. We thank you for this opportunity to share our views on the Home Corporation and Housing Opportunity Partnership Program components of the National Affordable Housing Act, S. 566.

At the center of State HFA activity are two federally authorized programs, the Mortgage Revenue Bond (MRB)/Mortgage Credit Certificate (MCC) program and the Low-Income Housing Tax Credit (the Credit) program. The National Affordable Housing Act proposes the continuation of these important homeownership and rental initiatives which are set to expire on December 31 of this year. Separate legislation to extend these programs has been introduced in both the House and Senate and has earned the overwhelming support of both Houses.

MRBs have helped provide financing for more than one million homes for first-time homebuyers nationwide. MRB beneficiaries are households of moderate means with median incomes of $26,000. Homes purchased with MRB assistance are modestly-priced, averaging $50,000 over the past five years. MCC have assisted another 25,000 first-time homebuyers in eighteen states since the program became operational just three years ago.

On the rental side, the Credit -- virtually the only federal stimulus of low-income housing production and rehabilitation -- has helped produce 120,000 low-income rental units since its start in 1987. Members of NCSHA now administer the Credit in 47 states and have seen a dramatic increase in the use of the Credit, from 19 percent of the national allocation in 1987 to almost 70 percent in 1988. HFAs project that over 90 percent of available Credit authority will be used in 1989.

State HFAs are in a key position to assist in the preservation of privately owned, federally assisted low-income housing, one-quarter of which HFAs have helped finance. The expiration of rental subsidies and the prepayment of mortgages threaten the continued low-income use of much of this housing stock.

Today, State HFAs are involved in much more than housing finance. State HFAs have evolved from their early role as capital conduits to a much more creative, innovative and all encompassing role as housing packagers and entrepreneurs. Where HFAs used to simply issue bonds and purchase loans, they now service and insure many of these loans, while providing technical assistance to developers and supportive services to tenants.

In their evolution, HFAs have devised programs to assist first-time homebuyers, renters, the homeless and others with special housing needs. These programs provide excellent models for the Home Corporation and with the investment of Housing Opportunity Partnership funds could be expanded and replicated across the country. A sampling of these innovative programs is provided below, beginning with the Michigan example and then drawing upon the broader HFA experience.

The Michigan Experience

The Michigan experience is an example of what one state can accomplish with resources and creativity and partnerships with local governments, nonprofit, and for-profit organizations. A strong foundation existed in the Michigan State Housing Development Authority (MSHDA), which has a long and impressive history of producing affordable housing, including:

- 40,000 apartments, most for low and moderate income families and senior citizens;
- nearly 30,000 homes, almost all for first-time homebuyers; and
- 17,000 home improvement loans, a third of which went to senior citizens.

MSHDA has helped landlords rehabilitate rental property, given grants to neighborhood groups and homeless shelters and started the Michigan Mortgage Program for homebuyers, the first of its kind in the country.

Yet, too many Michigan people still pay too much for their housing or live in dwellings that are physically inadequate. In the past three years, MSHDA has taken a new and careful look at how to meet growing affordable housing needs.

A $1 million grant program, The Competitive Grant Program, was established, offering nonprofit and neighborhood housing groups seed money or the last piece of financing for local housing developments. The 23 groups that won grant awards raised another $3 million in contributions from foundations, communities and private sources.

Grassroots solutions to local problems are now possible with this assistance. Deteriorating and abandoned homes have been renovated for low-income families. Reverse equity programs and alternative mortgage mechanisms have been created. Neighborhood beautification has begun. Most participating organizations have relied on volunteers and "sweat equity" programs.

MSHDA has committed another $1.5 million to this program for the next three years. A portion of these funds will be set-aside to train neighborhood housing leaders. These individuals will learn about the development process, financing and project administration.

The success of MSHDA's program was the stimulus for the State of Michigan's Neighborhood Builders' Alliance. Through the Alliance, an additional $7.3 million in state funds have been awarded to 128 local nonprofit groups to upgrade housing, improve education, fight crime and stimulate economic activity in their communities. Many applications could not be funded as the demand was so great.

MSHDA benefits from the strong support of its Governor's office. In his State of the State message this year, Governor James Blanchard announced Michigan's Affordable Housing Initiative, a series of proposals to improve access to housing, assist homeless shelters, expand rental housing production, offer financing to homeowners and help first-time homebuyers.

Among the initiatives are the Emergency Housing Apartment Program or EHAP; the Housing Opportunities Providing Equity Program, or HOPE; and the Homeownership Savings Trust Program, or HOST.

EHAP . . . is a demonstration project involving state agencies, community nonprofit groups, foundations and the private sector. Sponsored by Urban Initiatives, Inc., Michigan, Massachusetts, Connecticut and New Jersey are working to more productively use federal emergency shelter payments to provide transitional and long-term affordable rental units.

Private sources and government agencies will offer loans and grants to nonprofit housing corporations to finance the purchase, administration, construction and permanent financing costs associated with the renovation of existing buildings. Some units will be for emergency shelter, others for permanent housing.

Income generated from social services payments for homeless tenants and the rents paid by permanent tenants will cover operating expenses plus debt service. The nonprofit corporation will provide ongoing management and social services support to the homeless families. Upon the retirement of the debt service, all the units will become permanent housing.

HOPE . . . is a joint effort of the Michigan Department of Social Services and MSHDA. The first program of its kind in the nation, up to $2 million in low-interest mortgages are provided to public, private, nonprofit and for-profit housing providers to buy and renovate single-family and multifamily housing.

The units are then rented or leased to public assistance recipients whose shelter allowances will support the housing providers' operating expenses for the unit and debt service on the loan. MSHDA anticipates financing the purchase and renovation of approximately 100 housing units with the $2 million.

HOST . . . will help prospective first-time homebuyers save for a downpayment. Participants will make monthly payments to the Homeownership Savings Trust administered by the Michigan Department of Treasury.

Based upon the pre-selected value of a home, the length of the saving period, the downpayment percentage to be earned and the general location of the home, the state will guarantee the downpayment for the type of home chosen.

A portion of a previously authorized state bond issue, backed by the full faith and credit of the state, will be reserved for home purchases by HOST program participants. HOST is expected to be underway this summer.

The HFA Response To Changing Housing Needs: Models For The HOME Corporation

Like MSHDA, State HFAs nationally have undertaken a host of innovative programs across the broad spectrum of housing needs. Model programs are presented below in three categories -- homeownership, rental and special needs housing.

Homeownership Initiatives

State HFAs have financed nearly a million single-family loans at below market interest rates for low and moderate income homebuyers. As barriers to homeownership have varied over the years, so have the programs designed by HFAs.

Where downpayment is the greatest burden, downpayment assistance has been provided (over 15 states administer such assistance). When capital has not been available in rural areas, HFAs have delivered capital, often in tandem with other programs which alone would not work in these areas. When mortgage insurance has not been available to first-time homebuyers at an affordable price, or at all, HFAs have created their own insurance programs, or have created risk-sharing plans with existing insurers.

Where construction and land costs have made new homes unaffordable to first-time homebuyers, HFAs have negotiated with developers or acted as developers, to dramatically lower the final purchase price of such homes. Design awards have encouraged low-cost construction techniques and energy efficiency. Where rehabilitation has been the key to homeownership for first-time homebuyers, HFAs have provided funds for this purpose. Where vacant foreclosed properties have been available, HFAs have created special programs to utilize this housing.

The inability to generate enough savings to meet downpayment and closing costs presents one of the most serious barriers to homeownership for first-time homebuyers. Over 15 HFAs have designed assistance programs to address this problem --- programs such as matched downpayments (California HFA), sweat equity (California HFA), second mortgages (Minnesota, New Hampshire, New Jersey, Rhode Island and other HFAs), and revised underwriting criteria for insurers and lenders -- allowing thousands to access the homeownership market who otherwise would have been closed out.

Two states, Delaware and California, are considering changes in their state tax codes to permit IRA-like savings accounts for downpayments. However, the Michigan HOST program recognizes the further need to control for inflation in home prices.

Recognizing that areas of their states are not adequately served by mortgage capital, several HFAs including those in West Virginia, Vermont and Minnesota are developing the capacity to originate and service mortgages to serve these areas. By developing this capacity, the agencies are able to augment the private sector and respond to a clear housing need, the availability of mortgage capital.

Where tax-exempt bonds cannot fully address industry gaps, taxable bonds have been added. In Alaska, the state provides the majority of capital for all homebuyers. While tax-exempt bond funds serve those able to meet income and purchase price limits, taxable bonds serve those who purchase beyond those limits. In Minnesota, where improvement of existing homes was being overlooked, a home improvement loan program was created using both tax-exempt and taxable bonds.

The private mortgage insurance industry has recently been facing heavy losses and, as a result, has been less willing to serve the types of homebuyers who participate in HFA programs. In response, various agencies such as California, Vermont, New Hampshire, Maryland and Connecticut have crafted innovative mortgage bond credit enhancement programs, to the extent their resources permit. Massachusetts and Rhode Island are nearing the implementation stage as well.

Where Real Estate Owned (REO) properties are a serious problem -- such as in Texas, Oklahoma and West Virginia -- HFAs have crafted innovative solutions. West Virginia utilizes REOs in the FmHA inventory to serve large (often homeless) families whose incomes average well below $10,000 per year. The HFA guarantees the loan for the first three years -- the riskiest period -- and FmHA offers a loan with an interest rate based on the family's income, as low as one percent. In Colorado, a similar program using HUD foreclosed properties is coming on line, and in Oregon, the HFA makes some of its foreclosed properties available to local human service organizations for use as transitional housing until families can be permanently housed.

These and other innovative HFA homeownership initiatives are described briefly below:

√ Rhode Island Housing and Mortgage Finance Agency First Home Loan Program: Three-tier financing program for households with less than $23,000 income.

- √ California Housing Finance Agency Self Help Program: works with nonprofit development corporations to provide home loans to families with less than 80% of median income. Homebuyers are required to help construct their own homes.
- √ Florida Housing Finance Agency Affordable Housing Demonstration Program: Uses a state appropriated Housing Trust Fund to make permanent non-assumable loans to very low-income households.
- √ New Hampshire Housing Finance Agency and Vermont Housing Finance Agency blend financing to encourage low-income rural homeownership.
- √ Virginia Housing Development Authority Rural Homesteading Program: provides rehabilitation loans on foreclosed properties purchased with HUD homesteading funds and sold to eligible low-income families for $1.
- √ Wisconsin Housing Development Authority Low Downpayment/Low Marketability Area Insurance Program: uses agency funds to co-insure with a private mortgage insurer the mortgage on 95% loans.
- √ State of New York Mortgage Agency has financed every loan made under the federal Nehemiah Program.
- √ New Jersey Housing and Mortgage Finance Agency Lease Purchase Program: uses a portion of a families rental payment to count against a downpayment on the purchase of home.
- √ Maine Housing Authority Maine/Enterprise Program: involves rural and urban efforts with nonprofits for home rehabilitation and instruction in low-cost construction.

Rental Housing Initiatives

As with homeownership programs, state HFA rental programs have evolved as housing needs and resources have changed. Initially, HFAs were involved in HUD's 236 program and then the Section 8 program. When funding for the Section 8 new construction and substantial rehabilitation programs was phased out, agencies turned to a greater reliance on tax-exempt bonds -- the 80/20 program.

Changes in the 1986 Tax Reform Act have limited the use of tax-exempt bonds, causing HFAs to turn to other financial tools, such as the Low-Income Housing Tax Credit. A key to the success of these efforts has been the presence of state funds. State HFAs in Massachusetts (the SHARP program); Florida (the SAIL program); and Connecticut (the PRIME program), using state appropriations have broadened the impact of their bond programs through reduced interest rates, and in some cases, rental subsidies.

In other states, where state funds are not available, various resources are being drawn upon. State HFA resources, local resources and remaining federal resources are being combined to produce rental housing. For the most part, these efforts are tailored to specific projects and are not easily replicable. The New Jersey HFA, for example, has used six or more sources of subsidy to finance a single rental project.

Perhaps no better example exists of the creation of a model by HFAs in the post tax reform environment than the Low-Income Tax Credit experience. Created by the 1986 Tax Reform Act, this program was given to states to administer. Working closely together and through their national organization, the HFAs developed plans and procedures in the absence of regulatory guidance. Manuals and forms have been shared, technical meetings held and clearinghouse services provided that rely on the willingness of agency staff to share their experience with their peers.

Examples of model HFA rental programs are highlighted below:

√ California Housing Finance Agency State/Local Rental Housing Program: provides agency funds to buy down project take-out financing predicated on local government contributions and private capital. Program targets 80 percent of funds to low-income and 20 percent to very low-income.

√ Michigan Housing Development Authority Multifamily Developer Incentives Program: provides sliding scale interest rate financing for low-income rental housing targeted to distressed areas. Rental rate subsidy can equal $300 per unit.

√ West Virginia Housing Development Fund Construction Loan/FmHA Program: provides low-interest construction loans to FmHA projects in areas with limited capital markets.

√ Maine Housing Authority Rental Rehabilitation Program: provides financing for rental rehabilitation in areas not eligible to participate in the federal Rental Rehabilitation program, augmenting the loans with state rental assistance.

√ South Carolina Housing Finance Agency Public Rental Housing Project Program: develops projects, secures FHA financing and upon completion sells to developers rental projects in areas of crucial housing needs.

√ Colorado Housing Finance Agency Rental Acquisition Program: acquires distressed projects from owners using agency funds and owner financed bridge loans with financing insured by FHA 223(f), qualifying the project for 100 percent financing and reducing the rents.

√ Minnesota Housing Finance Agency Taxable Bond Program: provides 30 year financing for refinancing and rehabilitation of rental projects.

√ Massachusetts Housing Finance Agency SHARP Program: provides interest write-downs and rental subsidies with state appropriations.

- √ Maryland Community Development Authority Rental Housing Production Program: uses state general funds and revolving funds to provide low-interest, deferred loans for rental housing where all tenants are 60 percent of median income or below and 50 percent of tenants are below 30 percent of median income.

Special Housing Needs Initiatives

State HFAs are building upon their experience in financing elderly projects by providing supportive services. A $4 million grant from the Robert Wood Johnson Foundation is being used by ten state HFAs to develop supportive services packages for selected elderly housing projects. The models developed through this process will be available to other agencies. It is important to note that that Robert Wood Johnson commitment equals that of HUD's entire supportive services demonstration for public housing. The breadth and diversity of supportive services models among HFAs should be as rich, if not richer, than those in public housing.

Several HFAs, including Virginia, Colorado and Kentucky have already designed housing programs which include supportive services for families, particularly single-parent families. The experience with these programs (in some case modeled after HUD's "Project Self-Sufficiency"), will help other HFAs develop similar programs. As funding permits, HFAs are looking to expand the Robert Wood Johnson model to include services for families.

Although the first priority of state HFAs has always been to create a base of permanent affordable housing to prevent homelessness, homelessness is a reality. Most HFAs have begun to make some of their resources available for emergency and transitional housing, as well as for permanent stock. Assistance has taken the form of grants or loans for shelter or transitional housing construction or rehabilitation, operating costs or supportive services. Many of the HFAs are using their funds to match federal McKinney Act grants.

The New York HFA sold almost $14 million in tax-exempt bonds to finance development of a 200 unit shelter for homeless families and individuals in Brooklyn. Numerous private entities are supporting the project by providing services free or at cost. In Pennsylvania, $10 million dollars of the HFA's general fund revenues has been reserved for the development of multifamily apartments, reserved specifically for the homeless. Twenty-one providers have been funded under this program. In Oklahoma, the HFA was able to negotiate with the landlords of vacant apartments in order to move families from their waiting lists into units, at rents consisting of 30 percent of the family's income. High vacancy rates for multifamily property owners provided the impetus for this special arrangement with the HFA.

Iowa has begun reviewing proposals for the use of $100,000 in state appropriations targeted for the homeless. In Maine, six nonprofits were selected to participate in a demonstration project known as the "Homeless Family Transitional Living Project," which will offer longer-term transitional housing and social services to families with children (housing is available for up to two and one-half years). In Georgia, agency funds have been combined with federal funds to create a pool of over $1 million. Oil overcharge dollars were used to match HUD Emergency Shelter Grants, and a single application used, drastically reducing the paperwork burden for applicants. These and other innovative approaches have played a large part in increasing the amount of housing stock available to the homeless.

Further examples of State HFA efforts to support the housing needs of special populations include the following.

√ Connecticut Housing Finance Agency Reverse Annuity Mortgage Program: provides reverse annuity loans to low-income elderly homeowners needing an income supplement to live independently.
√ Georgia Residential Finance Authority Homeless Shelter Assistance Program: uses agency funds to provide low-cost loans to nonprofits building shelters and SRO housing.
√ Illinois Housing Finance Agency Elderly Housing Coordination Program: assesses the needs of elderly tenants and coordinates provision of services packages.
√ Kentucky Housing Corporation One-parent Family Facilities Program: provides affordable housing, career counseling, job training, and on-site day care for single parent families.
√ Michigan State Housing Development Authority Special Housing Programs: provides group homes for developmentally disabled and physically handicapped individuals.
√ Texas Housing Authority Community Group Homes Program: uses state and agency funds to finance community group homes for mentally and physically handicapped individuals in transition from institutions to self-sufficiency.

A Federal Role is Essential

Over the recent decade of federal budget cuts and adverse tax changes, the task of meeting housing needs has become much more difficult. States are responding, but like the federal government, are struggling against tightening budgets and increasing responsibilities across the spectrum of domestic programs. A federal commitment is needed if we are to adequately address the nation's growing housing concerns.

The nation is emerging from a period in which Federal housing assistance decreased from $32 billion in 1981 to $7 billion in 1987. In addition, the fundamental tax policies upon which housing investments have relied were dramatically altered by the 1986 Tax Reform Act. All of the imaginative and innovative state programs cannot supplant the historic leadership which the Federal government has taken in housing, leadership which has been missing for much of the past decade.

An important opportunity exists today to restore the Federal leadership, but in so doing, to build upon the program laboratory which now exists as State HFAs, localities, nonprofits, and the for-profits housing providers find ways to meet the housing needs being confronted. The National Affordable Housing Act takes a major stride toward the creation of a stronger partnership between these parties and the Federal Government.

Observations On The National Affordable Housing Act's Home Corporation and HOP Proposals

The National Affordable Housing Act proposes federal institutional and financial support for the design and implementation of affordable housing programs at the state and local level. A single, streamlined institution, the Government National Home Corporation (the Home Corporation) would be created within HUD to deliver housing assistance to state and local governments.

The HOME Corporation

The HOME Corporation would have three mandates:

- the provision of financial assistance to qualifying jurisdictions;
- the identification, refinement and promotion of model affordable housing programs; and
- the provision of credit enhancement.

Comment: State HFAs support the concept of a single, unified institution which would collect and refine information on model housing programs and disseminate it to state and local governments. State HFAs have designed many innovative programs ranging from homeownership to special needs housing which could be promoted and replicated nationally with the support of the Home Corporation.

State HFAs strongly support new, flexible funding for housing through HOP. These funds are desperately needed to augment state and local efforts, which are not sufficient to meet growing housing needs.

Housing Opportunity Partnership Program (HOP):

The HUD Secretary, acting through the Home Corporation, would make funds available to participating jurisdictions to expand the supply of affordable housing. Roughly three billion in HOP funds nationally is recommended for the first year.

Funding Allocation to State and Local Governments

Eighty percent of the HOP funds would be allocated by formula, 20 percent by national competition. The allocation formula would be based on a series of indicators, which would include the supply of affordable housing, the extent of poverty and the cost of producing housing.

Comment: The source of data upon which the formula allocations and strategic plans rely is very important. Ideally, 1990 census data will be available which would accurately reflect housing need. Influxes of immigrants and changes in the distribution of income and population resulting from structural economic changes could significantly alter housing needs within a state.

Traditional measures of housing need have included several characteristics of housing stock: the age of the unit, overcrowding and vacancies. These indicators should be tied with income or poverty levels, thereby focusing funding on the housing problems of those with low incomes and overcoming some of the bias that has favored cities with very old housing.

Change in per capita income should be taken into account along with the poverty level. For example, major structural changes in rural economies have affected population, the age distribution, employment levels and consequently per capita income. The UDAG program gave greater weight to per capita income change than to the poverty level.

The bill proposes to assess housing need partly on the basis of the "tightness of the housing market." If rental vacancy levels are used, many cities would be at a disadvantage because they currently have an excess of rental housing even though it may not be affordable housing. A more useful relationship between housing needs and vacancies might be vacancy rates in lower-income census tracts or the length of the waiting list for housing assistance.

State and Local Distribution:

Fifty percent of the formula funds would go to states, with each state receiving a minimum allocation of $3 million. If a state received less than $3 million under the formula, the needed increase would be deducted pro rata from the other state allocations.

Fifty percent of the formula funds would go to qualifying localities, which would receive at least $2 million. A locality with an allocation under $2 million could still participate if the HUD Secretary finds that:

- the jurisdiction is the city with the largest population within a metropolitan area, and
- the state authorizes the Secretary to transfer a portion of its allocation to the jurisdiction, bringing the locality's allocation to the minimum $2 million.

Comment: The legislation calls for a 50/50 split of HOP funds between states and localities, with states and qualifying localities receiving their funds directly from HUD. States argue with this distribution for it is the states who bring resources, capacity, experience and a proven set of programs to the housing problem. States would prefer to administer more than fifty percent of the funds, would accept no less than fifty percent and strongly object to a 30/70 percent state/local distribution as proposed by some local government groups.

NCSHA suggests a system under which all formula HOP funds would be allocated among states according to a housing needs based formula. Up to 50 percent of each state's share would then be directly allocated to localities meeting the minimum threshold amount established for localities in the legislation. At least 50 percent of the funds would be available to the state. Any HOP funds which were not allocated to qualifying localities out of the 50 percent local share would be available to the state for use in any jurisdiction according to the state's housing needs. In states in which no localities qualify to participate, the states should receive the full share entitled to that state.

By distributing HOP funds to localities through the states, two important issues are addresssed. First, states can best assess the affordable housing needs and priorities of the state and direct limited resources to the neediest areas. Qualifying localities' housing strategies should be considered in formulating statewide strategies to ensure coordination and maximize resources. States can best support local efforts with federal and state resources if they are aware of local housing needs and strategies.

Housing is the only domestic policy area where a strict state-local approach, such as that proposed in the legislation, continues to be considered. The separation between states and localities historically resulted from a malapportionment problem which created dominant rural influence in state legislatures a quarter century ago. As housing programs were being formulated during that period, direct allocation of federal resources to local governments was viewed as a way of ensuring that housing resources reached the cities. By contrast, it is the rural areas today which frequently voice concerns that housing resources are disproportionately channeled to cities.

To the extent that "local" is perceived as synonymous with the major urban areas and the program appears biased in this direction, the breadth and depth of public support may be diminished. While the rural title in S. 565/565 may help offset this perception, an allocation to major localities through each state's allocation will result in resources directed at the broadest state needs: urban, suburban and rural.

Housing Affordability Strategy

Jurisdictions qualifying for funding must submit a Comprehensive Housing Affordability Strategy to HUD. If the Secretary does not approve the plan, reserved funds would be reallocated. State funds would be reallocated evenly by formula and competition by local jurisdictions within that state. Local funds would be reallocated to the state within which the locality is located.

Comment: HFAs support the concept of comprehensive housing affordability strategies. Statewide strategies are needed to identify, prioritize and address housing needs. A number of federal housing programs, such as the Low-Income Housing Tax Credit, are beginning to call for such plans as a condition of funding. HFAs propose that a single set of requirements be imposed in each case, so that the same state plan can be relied on for each program.

Any local strategies should be consistent with the broader state strategies. Close cooperation between local governments receiving HOP funds and the states should be required and expressed in the strategies.

Distribution of Assistance

States and localities would be required to set aside 10 percent of their funds for housing developed, sponsored or owned by non-profits. If after 18 months, a portion of the set-aside funds remains, the participating jurisdiction would be allowed to invest 50 percent of these funds; the remainder would be made available by incentive allocation to nonprofit groups.

Comment: State HFAs have encouraged nonprofit involvement in the development of low and moderate income housing. HFAs have helped build nonprofit capacity through the provision of seed money, grants and loans and technical assistance to new and expanding nonprofit organizations.

HFAs' support a ten percent set-aside. However, unused set-aside funds should be available to the state to address state needs. By requiring that 50 percent of unused set-aside funds be returned to HUD and awarded to non-profits nationally on a competitive basis, states are denied their full formula allocation and the ability to use those funds in the state.

Eligible Uses of HOP Funds

HOP funds could be used for rental or homeownership: acquisition, new construction, reconstruction or moderate or substantial rehabilitation, and site improvement, conversion, demolition and other expenses. Jurisdictions may invest funds in: equity investments, interest-bearing loans, advances, interest subsidies, and other forms of assistance. Funds cannot be used to defray administrative costs or to provide direct rental assistance to tenants.

Comments: Maximum flexibility in the use of HOP funds is crucial. Today's housing problems range from declining homeownership to growing homelessness and relate both to the affordability and availability of units. Diverse problems require a multitude of solutions. States must have the ability to identify and prioritize housing needs and respond in the most practical and efficient manner. For example, a state must be free to emphasize new production over rehabilitation as housing needs dictate.

Income Targeting

Each jurisdiction must invest at least 40 percent of its funds in units occupied by very low-income households (50 percent of area median income or less).

No less than 80 percent of a jurisdiction's funds must be invested in units serving low-income households (80 percent of area median income or less).

Comments: HFAs are committed to the provision of low and moderate income housing and support directing limited resources toward that goal. New resources and existing programs must be integrated and coordinated for maximum impact, however.

NCSHA urges consistency in income targeting between HOP funds and the tax based programs, Mortgage Revenue Bonds, Mortgage Credit Certificates, Multifamily Housing Bonds and the Low-Income Housing Tax Credit.

The requirement that 80 percent of HOP funds be invested in units serving households of 80 percent of area median income or less will make it difficult to use HOP funds to support homeownership programs. Only those households at the lowest margin of the homeownership market might be able to be served at this income level. As a comparison, the Mortgage Revenue Bond (MRB) program, which is tightly targeted, allows loans to households whose incomes do not exceed 115 percent of the state or area median if the household has three or more members and 100 percent of median for one or two person households.

The 80 percent provision will make it difficult to use HOP funds in combination with MRBs. For example, a state might wish to use HOP funds to support a downpayment program to augment its MRB program. This restriction will be particularly limiting for states with little multifamily housing and for states such as Texas and Oklahoma, which have a glut of devalued single-family homes.

Rental Housing/Project-Based Targeting

Unit rents must not exceed fair market rents for comparable units in the area. At least 20 percent of the HOP assisted units must be occupied by very low-income households who pay no more than 30 percent of their adjusted gross income for rent. All HOP assisted units must be occupied by households who qualify as low-income (80 percent of area median income or less).

HOP units must be available to holders of rental vouchers, credits, or certificates. Rents for very low-income units may be adjusted for unit size in accordance with a formula prescribed in the legislation. HOP units also must remain affordable for the remaining useful life of the project or for as long as the HUD Secretary determines is feasible.

Comment: Rental project targeting should track Multifamily Housing Bond and Low-Income Housing Tax Credit targeting to facilitate the combination of these subsidies. Neither of these programs alone are sufficient to ensure the feasibility or long-term viability of projects under current targeting. Each requires additional subsidies.

Like the bond and Credit programs, the HOP program should allow a developer the option of setting aside 20 percent of a project's units at 50 percent of area median or 40 percent at 60 percent of area median. Each program should be allowed to work together with the others in the amounts needed. Consistent targeting is a key factor in the ability for programs to work together.

Homeownership/Program Targeting

Home purchase prices cannot exceed 95 percent of the area median purchase price as determined by the Secretary, with adjustments for different structures and new and old housing as appropriate. Homes must be the principal residence of the owner. Homes must be available for initial purchase only to families who have not owned a home in the previous three years.

Households must qualify as moderate-income (income does not exceed the area median family income as determined by the HUD Secretary with adjustments for family size and high costs) at the time of purchase.

Homeownership opportunities must be provided to families with a broad range of incomes, including a preponderance of low-income families.

Comment: Again, it is important that the homeownership program targeting is consistent with MRB targeting. The MRB program requires that household income not exceed 115 percent of state or area median income (whichever is greater) if the household has three or more members and 100 of the state or area median for one or two person households.

In addition, for homeownership, the average area purchase price as prescribed in U.S. Code Section 143(e)(2) for Mortgage Revenue Bonds should be used in lieu of the area median purchase price to ensure consistency among programs and facilitate combination where needed.

Matching Requirements

Each participating jurisdiction must make a matching contribution equivalent to at least 25 percent of funds received throughout a fiscal year. Cash contributions, administrative expenditures (up to 7 percent), the value of waived fees, the value of contributed land and other Secretary-approved in-kind services shall qualify as matching contributions.

Comments: States have and will continue to commit resources to the provision of affordable housing. The 25 percent match should be eased, however, for states suffering structural economic decline which significantly alters housing needs or the distribution of income and population.

In accounting for the match, a key concern is that the required match is met in the aggregate and not necessarily on a project-by-project basis. The requirement that the line of credit be matched "throughout" the year may be problematic. For example, conflicts could arise with the timing of state appropriations. Moreover, the percent of matching funds on a given project may be less than 25 percent while the match on another project may be more.

It should not be required that state matching funds be appropriated by state legislatures. In fact, such a requirement could result in the loss of state funds to housing. However, incentives to encourage the appropriation of new funds for housing, rather than the use of existing resources, should be considered.

Credit Enhancements

HOME would be authorized to provide guarantees to obligations secured by pools of mortgages on affordable housing. Mortgage pools could be formed by states, localities, Fannie Mae, Freddie Mac, Ginnie Mae or other approved financial institution.

Comments: NCSHA supports this feature of the legislation. Pool insurance has become extremely costly and difficult to secure for the market this program is designed to serve. With credit enhancement authority, HOME can leverage the additional private capital needed. The role of current secondary market participants, such as state HFAs, would be strengthened with this enhancement.

This credit enhancement could beneficial to mortgages to individuals or projects receiving HOP funds.

Conclusion

Only two years ago, NCSHA convened its Executive Directors to discuss what features we would like to see in the potential landmark housing bill which Senators Cranston and D'Amato were considering developing. When the opportunity arose to articulate our ideas to the National Affordable Housing Task Force, NCSHA prepared a paper, the essence of which relied upon certain premises:

- The legislation should increase public resources.

- The legislation should build upon the existing program foundation.
- Integration and coordination of public resources should be encouraged by the legislation.
- The legislation should provide maximum flexibility for states in using the resources provided.
- The legislation should encourage the leverage of additional resources, both public and private.

The HOME Corporation and HOP accomplish much of what was envisioned two years ago. Additional federal resources would be authorized. The funds provided through HOP could be used together with exiting programs to address difficult housing needs. An institution which would facilitate the integration and coordination of public resources would be created in HOME. A format for identifying housing needs and integrating and coordinating responses is provided in the state housing strategies. Flexibility would be given to states in using the HOP funds. And, the potential to leverage additional resources is designed into the program, both in the requirement for matching funds and through the credit enhancement capacity of HOME.

We commend you for this exemplary effort and pledge our continued support. We are pleased to offer the above refinements and will continue to work with you to ensure passage of this vital legislation.

STATEMENT OF

AMY S. ANTHONY
SECRETARY OF THE EXECUTIVE OFFICE OF COMMUNITIES AND DEVELOPMENT
COMMONWEALTH OF MASSACHUSETTS

on the

NATIONAL AFFORDABLE HOUSING ACT

before the

SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
U.S. SENATE

June 7, 1989

Mr. Chairman, Members of the Committee:

My name is Amy S. Anthony and I am the Secretary of Communities and Development for the Commonwealth of Massachusetts. My agency is responsible for administering housing and community development programs for Massachusetts. Therefore, I am pleased to be given the opportunity to comment on the "National Affordable Housing Act", particularly the provisions relating to the HOME Corporation.

Through my work as the President of the Council of State Community Affairs Agencies and as a member of the National Housing Task Force, I have travelled across the country and met with a wide variety of people in both the public and private sectors. I am struck by both the level and the diversity of housing activity taking place in states throughout the nation. While obviously states alone don't have the resources necessary to meet the challenges we face, many states have emerged over the last decade as active and willing participants in efforts to provide affordable housing for their citizens. Whether forced to do so by the virtual withdrawal of federal support, or because they realized the importance of the issue to the well-being of their citizens is not important. What is important is that states are in a far better position today than they were a decade ago - if given federal resources - to work effectively with local governments and the private sector to provide affordable housing.

However, this capacity is just beginning to be realized in many states. That is why the proposed HOME Corporation is such a necessary and innovative concept. As envisioned, the HOME Corporation - and the Housing Opportunity Program it will administer - personify the federal government's end of the partnership necessary to ensure our efforts actually succeed. What the HOME Corporation can do is to provide states with the funds and assistance to build the capacity it takes in the variety of actors needed to get the job done. The HOME Corporation recognizes that the federal government's role should not be one of rigidly defined programs imposed from on high, but one that reinforces the flexibility necessary to allow states and localities to tailor programs to meet individual needs. Such a recognition is particularly important, because it will allow the federal government to take maximum advantage of the emerging state role in housing development.

Through its ability to develop model programs, the HOME Corporation can help provide states with program designs that work. In so doing, it can help them structure and coordinate their own resources in the most effective fashion. In addition, the HOME Corporation can serve a coordinating function for programs and resources at the Department of Housing and Urban Development (HUD) and other federal agencies. It can ensure that these resources are brought to bear in ways which will foster state/local programs. For example, it can ensure that FHA insurance is made available to work in conjunction with the Housing Opportunity Program, or it can ensure that public housing modernization and private housing rehabilitation funds are made available where neighborhood revitalization efforts are underway. This knowledge of where funds are available and the ability to coordinate their delivery is key in ensuring that resources are used in the most efficient and effective manner possible.

The federal government should be attempting to promote certain positive behavior on the part of state and local government. The HOME Corporation can help this to happen. It is particularly critical to the future of any housing programs that they becoume fiscally accountable. States and localities must be encouraged by the HOME Corporation to design programs that provide the most housing affordability at the lowest possible cost. The HOME Corporation should be allowed to provide increased allocations to states and localities that establish programs to attract maximum private investment and achieve the largest impact per federal dollar, such as mixed-income housing. The bill's matching requirements should clearly allow state funds used for other than low-income units to be counted as part of the required match. Further, we need to ensure that the private sector remains an active and willing participant in affordable housing development. While non-profits are critical to any development and we should continue to strengthen their capacity, they can't do it alone. The private for-profit developer is essential. Strengthening their role in ways that guarantee long-term affordability is vital.

Finally, the HOME Corporation should encourage and reward maximum coordination and cooperation between states and localities. I feel that the bill would benefit greatly by requiring that local housing strategies be submitted to states for review and comment prior to submission to HUD. Predictability is crucial to the housing development process; states can help to ensure that there is consistency among localities within a state so that developers aren't forced to deal with widely differing program requirements from one community to the next. I would also suggest that certain matters such as rent control are better left to state and local decision-making. In this regard, I would urge the Committee to consider modifying the language contained in the bill relating to local housing strategies found in Section 105 (b)(4).

In Massachusetts, we have had considerable success in strengthening and reinforcing positive activity at the local level. We now have over 170 local housing partnerships throughout the state that have brought together the variety of actors needed to produce housing. We have provided grants to cities and towns to help them plan and develop the capactiy to deal with growth and development in ways that ensure affordable housing — not just for the elderly but for low-income families and those with special needs — will be built. While we have attempted to coordinate and broadly define programs at the state level, we rely on local officials and community leaders to work in partnership with us to tailor our programs to the needs of their city or town, and to make specific projects happen.

However, we can't just assume positive action at the local level. Often housing is still viewed as a negative by communities, particularly suburban communities. Even communities that welcome the location of job generating industries are sometimes reluctant to accept the housing required to support these workers. States can play a key role in providing both the carrots and the sticks needed to stimulate the acceptance of affordable housing at the local level.

I believe that this is what the HOME Corporation can help to achieve at the national level. Clearly federal resources are critical to meeting the affordable housing challenge we face, but equally critical is the way in which these resouces are provided. The HOME Corporation acknowledges the reality of what has taken place over the past decade, and seeks to capitalize on its positive side. In so doing, it will help to ensure that federal resources are provided in the most effective and efficient manner possible. By so doing, it will help to ensure that affordable housing will always remain one of this nation's top priorities, and that it will not loose its place on the national agenda again.

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STATEMENT

OF THE

ASSOCIATION OF LOCAL HOUSING FINANCE AGENCIES

TO THE

SENATE SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS

ON S.565

THE NATIONAL AFFORDABLE HOUSING ACT

JUNE 7, 1989

Mr. Chairman and Members of the Subcommittee:

The Association of Local Housing Finance Agencies (ALHFA) appreciates the opportunity to provide comment to the Senate Subcommittee on S. 565, the National Affordable Housing Act.

ALHFA is a nonprofit, national association of professionals in the field of affordable housing finance. Its 133 members are primarily city and county government agencies which finance homeownership and rental housing opportunities for low- and moderate-income persons. Affiliate members are those organizations which provide technical assistance to agencies. ALHFA's purpose is to serve its members as an advocate before Congress and the Executive Branch on affordable housing policy issues, and, through educational activities, to enhance the ability of local housing finance agencies to implement responsible and professionally-administered affordable housing programs for low- and moderate-income persons.

At the outset, ALHFA wishes to commend Chairman Cranston and Ranking Minority Member D'Amato for their tremendous leadership in helping to restore the issue of affordable housing for low- and moderate-income persons to its rightful place on the national agenda. S. 565, which has drawn considerable support from all sectors of the housing industry, is a testament to that leadership.

We also want to take this opportunity to commend the staff for their efforts to seek out ALHFA's comments as S. 565 was being drafted. We participated in numerous meetings and provided extensive comments; we are confident that this fine working relationship will continue as S. 565 makes its way through the legislative process.

Most of this statement is directed to the homeownership and rental production provisions. We do want to note, however, ALHFA's general support for the preservation, low-income rental assistance, and supportive housing provisions.

HOMEOWNERSHIP

As Subcommittee members undoubtedly know, next to having an adequate monthly cash flow to support a mortgage, the greatest difficulty faced by lower-income, prospective first-time homebuyers is scraping together enough funds to make a downpayment. S. 565 properly addresses both problems, first by proposing a three-year extension of the authority to issue tax-exempt Mortgage Revenue Bonds and Mortgage Credit Certificates, and second by making it easier to finance a downpayment.

The Mortgage Revenue Bond Program has served for many years as a key tool utilized by local housing finance agencies to provide below-market-rate mortgages to low- and moderate-income, first-time homebuyers -- those whom the conventional mortgage market has left behind. Extension of the December 31, 1989 sunset on authority to issue MRBs and MCCs is critical.

ALHFA is particularly pleased to note that the legislation calls for replacing the current national ceiling on FHA-insured mortgages with a ceiling that includes state or substate ceilings. The current national ceiling, as you, Mr. Chairman, and Senator D'Amato well know, has rendered the FHA program largely unworkable in many high-housing-cost areas, such as the New York Metropolitan area, Los Angeles, and San Francisco.

We likewise support the easing of downpayment requirements under the FHA program and permitting FHA to insure adjustable rate mortgage. We believe the additional opportunities for access to affordable housing by lower-income individuals far outweighs the possibility that they may be a greater credit risk.

RENTAL PRODUCTION

Title III of S. 565 establishes a new $3-billion "Housing Opportunity Partnership" (HOP) program to assist local governments and states to produce affordable rental and homeownership opportunities targeted to households of low- and moderate-income. Its principle features are:

1. a new HOME Corporation created to administer the HOP program and provide credit enhancement for mortgages on HOP-assisted projects;

2. The $3 billion is divided 80 percent for entitlements to participating local jurisdictions and states and 20 percent for competitive applications;

3. Of the entitlement portion, 50 percent is available for participating local jurisdictions (if their formula share is at least $2 million) and to states (with a $3 million minimum state share);

4. If a local jurisdiction gets less than $2 million, it may still qualify if it is the largest jurisdiction in a metro area and the state agrees to provide the difference between its formula amount and $2 million. Consortia of local governments can join together to receive an entitlement;

5. The formula is to be developed in regulations and is to account for each jurisdiction's share of the nation's need for affordable housing for low- and moderate-income families of differing size, measured by tightness in the housing market, inadequate housing, poverty, and costs of production;

6. A jurisdiction's formula amount is allocated as a line of credit and is termed a housing investment trust fund; funds must be used within 2 years;

7. Forty percent of HOP funds must be used for households at 50 percent of median or below, and 80 percent for those at 80 percent of median; 100 percent of the funds must be used for housing that is affordable (i.e., rents at Fair Market Rents); at least 20 percent of the units must be reserved for those at 50 percent of median paying no more than 30 percent of income for rent; units must be available for occupancy only by low-income persons (80 percent of median); owners cannot discriminate against Section 8 certificate holders; and the housing must remain affordable for its useful life;

8. Mixed-income projects (i.e., affordable housing that accounts for less than all of the units in a project) qualify as affordable if they meet the criteria in (7) above;

9. Funds must be matched by either cash, administration costs up to 7 percent, fees foregone, or land donations;

10. Applicants must prepare a five-year housing strategy which identifies needs, resources, and an analysis of the jurisdiction's public policy impact on affordable housing and what actions it will take to ameliorate the housing situation;

11. Funds can be used for a variety of purposes including new construction, moderate or substantial rehabilitation, acquisition, relocation or homeownership, but not for administrative costs nor for rental assistance; and

12. The HOME Corporation is authorized to guarantee securities backed by mortgages from HOP-assisted projects.

As a general comment, ALHFA strongly supports the thrust of the HOP program as a flexible efficient mechanism to enable the federal government to invest, through a line of credit, in local housing strategies. Although the funding level of $3 billion is modest, it does represent a foundation along with tax code incentives, upon which to build. In other words, it returns the federal government to a partnership role in stimulating new affordable housing opportunities.

ALHFA also supports creation of the HOME Corporation -- a single focal point within HUD to which local housing finance agencies can turn for financial assistance, credit enhancement, and technical support.

ALHFA is particularly pleased to see a credit enhancement program for rental housing. The current lack of such a program is a serious problem for local housing finance agencies. We support authorizing the HOME Corporation to guarantee securities backed by mortgage pools formed by localities, states, or consortia.

In addition, ALHFA supports the requirement that applicants prepare a five-year housing strategy which identifies needs, resources, and analysis of the jurisdiction's public policy impact on affordable housing and what actions it will undertake to ameliorate the housing situation. Such a strategy is essential to the national, as well as local, success of the HOP program.

OTHER ISSUES

There are several areas in Title III which are of concern to ALHFA.

First, ALHFA does not favor the 50 state/50 local split of funds. As we have previously told the Subcommittee, we strongly believe that the bulk of the funds should be allocated to local governments. While a few states have developed exemplary programs to address low- and moderate-income housing needs, this should not be taken as a measure of overall state capacity or political will. Perhaps a more appropriate measure would be criteria based on housing need and track record in responding to that need, such as through participation in housing production programs. ALHFA is working with its sister local government associations in an attempt to fashion an alternative allocation -- one which is better reflective of need and track record.

We note that the legislation provides that the formula for distributing funds is to be set forth in regulations, based generally on need for affordable housing by households of differing size measured by tightness in the housing market, inadequate housing, poverty, and cost of production. While we agree that these are important factors to be considered, we strongly feel that the formula should be set forth in the legislation. That way the various formula elements and the weight attributed to them can be openly debated within

Congress. We also believe that in counting need, double counting should not be permitted (i.e., by a state and separately by localities within a state). Otherwise, limited financing is too diffused.

ALHFA supports the targeting provisions of S. 565 and the specific eligibility for mixed-income housing. Such housing, mixing market-rate units with targeted units, responds favorably to lessons learned from past federal housing programs (i.e., mixed-income housing produces a positive housing attitude and environment). We believe, however, that the language in Section 315(a)(2)(4) Mixed-Income Project is confusing in its reference to "... shall qualify if such housing meets the criteria of this section." Section 315(a)(1)(c) requires such "housing" to be ..." occupied only by households that qualify as low-income families." We believe this can be clarified by referring to the assisted units rather than the project as a whole.

The final area of concern is with the matching requirements. ALHFA does support a matching requirement and specifically supports the provision to allow a phase-in over three years for financially hard-pressed communities. We do believe that real estate tax abatement should be an eligible contribution as well as bond issuance fees. Furthermore, the limitation of seven percent of HOP funds as eligible administrative fees might be too restrictive for some communities.

Before concluding we want to urge the Subcommittee to move forward in reauthorizing the various housing and community development program for at least one additional year in order to allow Congress sufficient time to enact major new legislation along the lines of the National Affordable Housing Act. As part of such reauthorization we strongly urge the Subcommittee to extend those fifteen-year Section 8 contracts which expire in 1990. Thousands of units are at risk if Congress fails to act. ALHFA urges your immediate action on this matter.

CONCLUSION

We believe, Mr. Chairman, that immediate passage of the National Affordable Housing Act, with the changes herein suggested, is of critical importance in responding to the nation's affordable housing crisis. We pledge our assistance to the Subcommittee and the Congress to this end.

TESTIMONY OF ERIC EICHLER
ON BEHALF OF THE NATIONAL MULTI HOUSING COUNCIL BEFORE THE SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS OF THE SENATE BANKING, HOUSING AND URBAN AFFAIRS COMMITTEE

June 7, 1989

My name is Eric Eichler. I am on the Board of Directors of the National Multi Housing Council. I am also a Managing Partner, and the Chairman and Chief Executive Officer of The Linpro Company. Linpro is a national real estate development and investment company. Linpro develops many types of entry level housing projects, both for rent and for sale. We also have specialized in the development of large P.U.D. projects that generally are completed over a 10 to 20 year schedule. Linpro is also active in the development of industrial, retail and commercial projects, including suburban and urban large scale and high rise buildings. Approximately 50 percent of our annual volume is in the residential sector.

I am pleased to submit this testimony on behalf of the membership of the National Multi Housing Council ("NMHC"). Based in Washington, D.C., NMHC represents the interests of the largest and most prestigious organizations in the country participating in the multifamily rental housing industry. NMHC's members are engaged in all aspects of the development and operation of rental housing, and together account for the building, ownership, financing and management of millions of rental units.

NMHC fully supports the Subcommittee's goal of providing every American family a decent and affordable home in a suitable environment through enactment of national affordable housing legislation. In many communities across the country, it is increasingly difficult for low- and middle-income families to find adequate and affordable housing. Decent and affordable shelter is the heart of the American dream, but for too many Americans, it remains no more than a dream.

This legislation attempts to address the broad range of concerns that must be part of any effective national housing policy, and NMHC commends the Subcommittee for this expansive vision and effort. We note, however, that one significant component of an effective policy -- preservation of existing housing -- is not directly addressed by this proposed legislation. NMHC remains ready to assist the Subcommittee in developing legislative proposals to address the critical preservation issue.

NMHC endorses the Subcommittee's effort in this proposed legislation to define contributing roles for a whole range of players who together can ensure the nation an adequate supply of affordable housing. Most significant to NMHC is the Subcommittee's recognition of the vital contribution to be made by conventional multifamily housing developers. NMHC believes the key to the success of any new national housing program will be its ability to draw on the resources and experience of those major developers who have proven their ability in the marketplace to produce affordable rental and other housing. In this regard, NMHC and its members are ready and eager to assist the Subcommittee in its efforts to craft fair and effective affordable housing legislation.

As a national organization representing developers and owners of rental property, NMHC's comments today focus principally on the Subcommittee's proposed policy for the rental housing market. The central and critical problem facing the U.S. rental housing market is the inadequacy of the housing supply in certain areas of the country. Only by stimulating production of new multifamily housing in areas of short supply, and preserving the existing stock of subsidized and unsubsidized rental housing in these and other regions, can we hope to stabilize and increase the supply of affordable housing. To this end, NMHC believes new affordable housing legislation should pursue the following goals:

-- elimination of federal and state housing rules that impose unnecessary additional costs on new construction;

-- elimination of federal banking regulations that discourage construction of new multifamily rental housing;

-- restoration of tax incentives to build and own affordable, low- and moderate-income multifamily housing;

-- explicit authorization and encouragement of appropriate investment by pension funds in low- and moderate-income multifamily housing; and

-- preemption of local rent control laws that discourage investment in low- and moderate-income multifamily housing and interfere with or impede the goals of federal housing policy.

These proposals represent NMHC's preliminary views on the steps that can be taken to encourage multifamily rental housing. We look forward to working with the Subcommittee and its staff on these and other proposals in coming months, as new affordable housing legislation takes shape.

* * *

A. The Private Sector Must Be Encouraged To Play A Central Role in Providing More Affordable Housing.

In the last 40 years, this country has made remarkable progress toward housing its people -- both rich and poor. Most Americans are better housed today than at any time in our history, and we are better housed than any other people in the world. Nearly two-thirds of all American families own their homes, and there are few families -- although still too many -- who do not have some form of basic shelter.

This truly historic success could not have occurred without the private housing industry, or without the essential support provided by a carefully coordinated federal housing policy. Through tax incentives and housing development programs, Congress provided the housing industry with the tools to build housing for the entire nation. And to a remarkable degree, the industry has done so.

NMHC's central message today is that new affordable housing legislation can be effective only through renewal of this partnership of the public and the private sectors. Only by drawing on the resources and experience of the private housing industry can Congress hope to make rental housing more affordable and available.

B. Reducing the Cost of Producing Housing Must be an Essential Part of a New Affordable Housing Strategy.

The problem of affordable housing has been described as "the growing gap between peoples' incomes and the cost of housing." As this gap has widened, housing has become less affordable.

To close this gap between what housing costs and what people can afford to pay, Congress must look both at producer costs and consumer income. As builders and owners of housing, NMHC's proposals focus principally on the cost side: that is, what can be done to reduce the cost of building new housing and preserving existing housing (and so to encourage greater supply and reduce pressure on housing prices).

Expanding the supply of affordable multifamily rental housing requires new federal policies that stimulate multifamily housing production, eliminate disincentives to production, and help to preserve the existing stock of rental housing. NMHC believes these important goals can be furthered by including in the National Affordable Housing Act provisions to accomplish the following: 1) limit unnecessary costs imposed by federal and state regulations; 2) end current federal banking policies that discriminate against multifamily housing; 3) restore tax incentives to build and own low- and moderate-income multifamily housing; and 4) encourage appropriate pension fund investment in entry-level multifamily housing market.

1. Congress Should Limit Unnecessary Costs Imposed by Federal or State Regulations.

The Subcommittee should closely examine ways to reduce unnecessary costs resulting from federal and state regulation of housing construction. Although little can be done to make bricks, mortar and other building materials less expensive, Congress can effectively control construction costs associated with federal and local regulation.

Federal Regulatory Costs

Regulation of building construction is ordinarily a purely local matter. But in pursuit of national policy goals, the federal government has increasingly begun to regulate the design and construction of housing. In the recently enacted Fair Housing Amendments Act of 1988 ("FHAA"), Congress imposed extensive building requirements on the construction of every new covered multifamily housing project. As Congress' attention now turns from accessibility to the problem of housing affordability, the FHAA must be carefully reviewed to ensure that only those costs necessary to provide reasonable handicapped access are imposed on the housing industry.

NMHC and its members have long supported the FHAA's goal of preventing housing discrimination against the handicapped, and we support many of the changes made last year in the Fair Housing Act to accomplish this result. There is increasing evidence, however, that the costs of implementing several of the FHAA's handicapped access provisions will be far higher than Congress intended when it enacted this important legislation last year.

Most Members of Congress, including the FHAA's sponsors, believed the cost of providing universal handicapped access would be relatively minimal. The figure most often cited during floor debate was that the most basic changes required by the new legislation would cost no more than $4-$27 per unit -- and that in no case would total compliance costs be more than a few hundred dollars per unit.

But in fact, recent studies suggest that compliance costs for new construction are likely to be closer to $4,000 per unit, based on the American National Standards Institute ("ANSI") standards referenced in the FHAA. (In order to take advantage of the "safe harbor," a developer must comply with the ANSI standards, until HUD adopts a more definitive interpretation.) Further, at some sites, entrance accessibility requirements and the need to use lower-density designs could lead to costs of up to $7,000 per unit. NMHC estimates the impact of these added construction and development costs on tenants will be an increase of about $79 in monthly rent for a newly-constructed apartment. Alternatively, these new costs may be passed along in smaller, across-the-board increases in rents paid by all tenants, in both new and existing apartments. However this added cost is passed on to consumers, the handicapped accessibility requirements can be expected to significantly reduce housing affordability for many people -- particularly the poor, who can least afford it.

The tension between implementing the FHAA handicapped accessibility requirements and lowering housing costs is obvious. But in NMHC's view, prudent policies could be adopted to substantially lessen that tension. We believe the FHAA's laudable goals can be achieved without this immense cost to housing consumers.

Although there may be specific steps that Congress could now take to ensure that only necessary handicapped access costs are imposed, such action would be premature. Before proposing specific legislative remedies, NMHC and its members are working with responsible officials at the U.S. Department of Housing and Urban Development ("HUD") in a cooperative spirit to encourage full compliance with this important civil rights legislation.

By first working with HUD, NMHC wants to give the FHAA a change to work while we seek (1) cost-effective accessibility guidelines that meet our members' concerns about the expense of specific design and construction requirements for new multifamily dwellings mandated by the FHAA, and (2) a fair and equitable transition to full compliance with design and construction requirements without economic disruption for either developers of multifamily projects or to tenant affordability of multifamily units.

Multifamily developers and owners are a resilient, entrepreneurial breed, and we are hopeful that our efforts with HUD will achieve the relief we seek through the administrative and regulatory process. Indeed, the promulgation of reasonable accessibility guidelines and amendments to HUD transition provisions will go a long way towards resolving our concerns. However, in the event HUD administrative rules do not provide a realistic and workable approach, NMHC will certainly advance to the Congress in the future a legislative proposal, respecting the concerns of the civil rights community, that preserves all of the important and essential gains of the FHAA, yet minimizes the impact of the implementation of expensive design and construction requirements on the affordability of new multifamily housing.

Local Regulatory Costs

Along with other responsible developers, NMHC and its members support construction regulations that contribute to the health and safety of housing consumers. Not all local regulations contribute to these important goals, however. Some are merely designed to raise municipal revenues, and others are inefficient or ineffective.

Industry analysts estimate that as much as 20 to 25 percent of the cost of constructing housing (excluding the cost of land) can be eliminated by reforming existing local housing codes and building permit procedures. Although some communities around the country have adopted progressive housing codes and procedures, many have not done so.

NMHC is extremely concerned that the array of local governmental regulatory burdens, coupled with regulatory costs at the state and federal levels, is forcing the cost of multifamily housing higher and higher as a percentage of tenant income. Without a concerted effort by policymakers to combat this problem at all levels of government, the era of affordable apartment living is over.

NMHC believes that local governments should be encouraged to reform building codes, infrastructure requirements, zoning restrictions and impact fees to eliminate unnecessary regulations that serve only to increase the cost of multifamily housing, without a corresponding benefit to health, safety, or quality of life. Local communities should also be encouraged to streamline their paperwork processing of builders' applications and permits, keeping in mind the fact that regulatory delays increase the cost of housing by increasing carrying charges on borrowed capital, which, when passed on to the housing consumer, make housing less affordable.

NMHC believes that the state and local housing strategy approval process outlined in the bill is an important tool for federal housing policy officials to use in encouraging local communities and states to reform burdensome regulatory policies. In submitting a housing strategy, state and local governments are directed by Section 105(b)(4) to identify how the cost of housing or the incentives to develop, maintain, or improve affordable housing are affected by the jurisdiction's public policies, and to describe strategies to address the negative effects of these state or local policies -- particularly policies affecting land and other property, land use controls, building codes, fees and charges, growth limits, and policies that affect the return on residential investment.

One area in need of special attention where the Subcommittee can strengthen section 105 is an amendment to give rental housing providers quick relief from the scourge of drug-dealers in apartment complexes. The Subcommittee's efforts to provide a better housed America can be reduced to naught in local communities if drug dealers in effect are permitted to take over rental housing complexes due to cumbersome eviction procedures. NMHC urges that, as a condition of federal housing assistance, state and local housing strategies include a commitment by the local jurisdiction to adopt expedited eviction procedures for tenants in rental housing who are involved in the illegal manufacture, distribution, or sale of controlled substance.

NMHC applauds the Subcommittee's efforts in crafting the state and local strategy section of the bill. We believe it, or a stronger provision, is an absolutely essential provision of any final national affordable housing legislation.

2. Congress Also Should Eliminate Federal Banking Regulations that Discriminate Against Lending to Multifamily Housing.

In addition to finding ways to reduce unnecessary costs created by regulation of housing construction, the Subcommittee should closely examine current federal banking policies and practices that discriminate against multifamily housing. Federal lending and guarantee institutions often show a marked preference for loans to construct single-family, as opposed to multifamily, housing. This preference, most recently evidenced in proposed Federal Home Loan Bank Board loan reserve requirements that would discriminate against multifamily housing loans, has depressed production of new multifamily housing.

NMHC strongly believes that this unreasonable preference should be eliminated, and that a new federal housing policy should actively encourage, rather than discourage, construction of new multifamily housing.

In particular, we believe the Subcommittee should closely examine the highly discriminatory risk-based capital reserve requirements for lenders currently being considered by the Federal Home Loan Bank Board. Under proposed new rules, the Bank Board would require lenders to maintain reserves in proportion to the risk of the loans they make. Although NMHC does not object in principle to this proposed requirement, the proposed rules in their current form would blatantly and unfairly discriminate against (and discourage production of) multifamily housing.

The proposed rules would require a 50 percent reserve for loans to build qualified one-to-four unit family residential housing, yet require a 100 percent reserve for loans to construct multifamily housing (that is, housing of five units or more). Further, although the proposed rules would provide for flexibility in setting reserve requirements for single family construction (e.g., lowering the reserve requirement for loans with a low loan-to-value ratio), there would be no such flexibility for multifamily construction. The new rules would set the same reserve for a multifamily construction loan with a 50 percent loan-to-value ratio as for a loan with a 95 percent loan-to-value ratio.

Where it can be demonstrated that qualified loans for conventional multifamily construction are no more risky than similar loans for single-family construction, there is no sound basis for imposing a higher reserve requirement on multifamily housing. To the contrary, such a policy directly conflicts with the Subcommittee's goal of providing all Americans -- including those who can only afford to rent rather than buy housing -- with adequate and affordable housing. The only fair policy is one that treats all loans, whether for single-family or multifamily construction, on an equal basis, setting reserve requirements based solely on objective evidence of their relative risk.

3. Congress Should Restore Targeted Tax Incentives to Build and Own Affordable, Low- and Moderate-Income Multifamily Housing.

Another obvious instance of federal practices disfavoring low- and moderate-income multifamily housing is the tax code.

Since its inception, the national housing policy has primarily relied on the private market to supply the nation's housing, driven and directed in its investments by governmental incentives. The most effective of these incentives has been the tax code. However, federal tax policy has discriminated against rental housing, as opposed to single-family housing. An apartment developer cannot deduct losses from rental property against income from other business activities such as property management, while a developer of single-family homes -- like taxpayers in every industry other than rental property -- faces no such restriction on business losses. NMHC strongly believes that federal tax policy should be coordinated with the national housing policy, and should actively encourage the building and owning of low- and moderate-income multifamily housing. Current tax policy, particularly the passive loss limitations, discriminates against building and owning low- and moderate-income multifamily housing.

The 1986 tax reforms eliminated any tax incentive to build and own multifamily housing, with the unsurprising result that annual production of new rental units has dropped dramatically in the last several years from 670,000 multifamily starts in 1985 to 398,000 in 1988. Just as important, the tax changes also significantly increased the cost of rental housing an estimated 15 to 25 percent.

NMHC supports a targeted restoration of the pre-1986 tax incentives to promote building and owning affordable, low- and moderate-income apartments. The targeted restoration of tax benefits should include (1) relief from passive loss limitations, and (2) permission to use accelerated depreciation schedules for multifamily construction targeted for low- and moderate-income residents; the greater the percentage of the property's units serving low- and moderate-income persons, the greater the targeted tax benefit available.

NMHC stands ready and willing to work with the Subcommittee, and in cooperation with congressional tax-writing committees, to craft a proposal for targeted tax relief to be incorporated in tax legislation. NMHC believes that such targeted tax incentives could stimulate construction of new low- and moderate-income rental housing where it is in short supply, and, in the long run, would reduce the overall cost of rental housing as a percentage of tenant income.

In addition, the availability of such targeted tax incentives to the existing low- and moderate-income stock would contribute to the preservation of affordable housing by assisting distressed properties in danger of foreclosure. As such, targeted tax relief could arrest or forestall the sharp decline in investment in affordable housing currently fueled by post-1986 federal tax policy.

The targeted tax incentives for affordable housing we have discussed, coupled with the extension and modification of the low-income housing tax credit, will stimulate the supply of housing affordable to lower-income families. Even with the more effective subsidy programs promoted by this Subcommittee, many less affluent Americans will continue to depend on the unsubsidized rental housing market for shelter. Lowering costs to ensure affordability in this market must be a critical part of the federal housing policy.

The underlying impetus of the 1986 tax reforms was an attack on tax loopholes and shelters. However popular this attack may have been as a matter of tax policy or electoral politics, it was shortsighted in light of its impact on housing affordability. A developer who relies on tax incentives to finance the construction of a new apartment project is not exploiting the tax system. He or she is putting money where Congress has said it wants investment, and is acting as a partner with the federal government in providing low- and moderate-income Americans with affordable housing.

NMHC encourages a return to that partnership -- one that in past decades succeeded in making the people of this country the best housed in the world. Tax policy has been a necessary and effective federal contribution to this partnership, and should once again be used to actively encourage the construction and preservation of affordable multifamily housing.

4. New Legislation Should Encourage Increased Access to Pension Fund Assets.

The Subcommittee should also seriously examine ways to identify new sources of capital financing for the multifamily housing market, and ways to create and provide incentives for lower-cost financing. Such capital investment could be encouraged by a variety of mechanisms, some of which I will discuss today. If available, more financing at lower rates could significantly reduce upward pressure on housing costs.

The cost of money is often the single most important determinant of whether a developer will find it economically feasible to build rental housing. During the period from the Second World War until the mid-1970's, when much of the nation's existing housing stock was built, the housing market had access to relatively inexpensive capital. Capital financing borrowed at low interest rates -- usually single-digit rates -- drove the market and housed America.

But in the late-1970's, low-cost financing virtually disappeared. High inflation drove up interest rates and, over time, fundamentally altered U.S. savings patterns. Formerly, Americans had saved for their old age and for the proverbial "rainy day" by putting their money in banks and thrift institutions, which historically paid depositors low rates of interest. In turn, federal policy caused banks and thrift institutions to lend out this money to the housing industry at equally low rates.

Today, Americans consider the money they deposit in banks and savings and loan institutions to be investment capital, and most depositors demand market-rate returns on their investments. Because these institutions must now pay a much higher interest rate on customer deposits, they must also charge more when loaning out that money. To recover this additional cost of borrowing capital, developers in turn have had to raise housing prices to consumers.

Identifying New Sources of Financing Capital

NMHC believes that federal policy should seek to create and provide incentives for new sources of capital financing for the housing industry. One possible source is the billions of dollars American workers annually put into pension funds. Yet, although we are beginning to see a knowledgeable entry by pension funds into financing for rental housing, fund involvement is usually targeted towards upscale, luxury multifamily complexes rather than affordable, low- and moderate-income apartments because funds seek investments that approach market rates of return.

In the past few years, pension funds have shown increasing interest in real estate investment. It is estimated, for example, that the institutional capital available for real estate investment may increase by as much as $250 billion in the next ten years. Generally, however, of pension fund investments, less than one-half of one percent is devoted to multifamily housing.

Currently, the greatest barriers to pension fund investment in multifamily housing are the cautious attitudes of fund administrators and investment counselors because of the protective standards of the Employee Retirement Income Security Act ("ERISA"), and lack of knowledge about multifamily housing finance markets.

Section 404 of ERISA imposes rigorous fiduciary obligations on pension fund administrators. Pension fund administrators must make only "prudent" investments and must administer the pension fund for the "exclusive benefit" of the plan fiduciaries and their beneficiaries. This rigorous mandate, enforced through stiff penalties, has discouraged pension fund administrators from investing in housing, in large part because they may not understand the housing market as well as they understand other markets. The safest way for a cautious administrator to meet ERISA's "prudent investment" requirement is to limit fund investments to the stock market, which for most administrators is a known environment. Thus, although ERISA does not prohibit pension fund investments in housing, its protective standards have in fact discouraged such investments -- even when those investments would be both prudent and beneficial to plan participants.

NMHC believes pension funds should be affirmatively encouraged to make appropriate investments in the multifamily housing market, targeted specifically for low- and moderate-income housing. To encourage increased access to pension fund assets for housing financing markets, Congress should include in new affordable housing legislation an explicit authorization of pension fund investment in multifamily housing, perhaps through appropriate report language. Such encouragement from Congress would in no way change the current substantive law governing pension plans; it would serve to eliminate any current uncertainty about the propriety of pension plan investments in multifamily housing.

Making Financing Available at Lower Interest Rates

More ambitiously, Congress should also closely examine proposals for more innovative ways of using pension fund investment to create sources of lower-cost financing for multifamily housing. In NMHC's view, one such idea is to provide a tax incentive for pension fund investment at below-market interest rates in multifamily housing development, provided the incentive is specifically targeted to low- and moderate-income housing investments.

There are many ways Congress could encourage pension fund investment in the multifamily housing market at below-market rates. For example, Congress could provide that a pension fund's current tax-exempt status would be partly removed if in the past year the fund had not devoted some specified part of its investment assets to below-market financing of multifamily housing development. In past decades, similar tax incentive was effective in making savings and loan institutions the center for low-cost housing financing in their communities.

NMHC is ready to work with the Subcommittee and staff to develop a specific legislative proposal for such a tax incentive, or some other innovative means of encouraging pension funds investment and using pension fund assets as a new source of lower-cost financing for low- and moderate-income multifamily housing.

C. Congress Also Should Limit Local Rent Control Laws.

As I noted earlier, the central and critical problem facing the U.S. rental housing market is, in certain areas, the inadequacy of housing supply. In NMHC's view, there is no more serious or perverse barrier to an expanded supply of rental housing in areas of shortage than local rent control laws. These laws, which vary from jurisdiction to jurisdiction, impede the operation of both the marketplace and the numerous existing Federally-sponsored housing programs.

NMHC believes that federal preemption of local rent control laws must be an essential part of any new housing policy. NMHC specifically suggests that any new affordable housing legislation should prohibit state and local governments from enacting rent control laws that interfere with or impede the goals of federal housing policy. This fundamental principle of federal-state relations is implicit in existing law, and already has been relied on by HUD in identifying the circumstances in which the Department will preempt local rent control laws.

In support of a federal preemption policy, NMHC wishes to bring to the Subcommittee's attention a recent major study on rent control by noted housing economist Anthony Downs. Dr. Downs is a Senior Fellow at the Brookings Institution, was a member of the Douglas Commission on Urban Problems and a principal consultant to the Kerner Commission on Civil Disorders, and has written or co-authored 15 books and more than 300 articles on housing and other issues.

Dr. Downs' study, which was earlier provided to the Subcommittee, found that rent controls are an ineffective and often counter-productive response to rising housing costs, and that residential rent controls generally worsen housing shortages and fail to overcome the lack of income, which is at the root of most housing problems for poor and lower-income families.
Dr. Downs also found that rent controls generally are "neither an appropriate nor effective response to perceived housing

shortages," and that "the social and economic costs and disadvantages of rent controls outweigh perceived short-term benefits they provide."

The Downs' study and the studies on rent control that preceded it have clearly demonstrated that rent control is an ineffective and often harmful housing policy. Nonetheless, local rent controls continue to be imposed around the country, severely restricting the quantity and quality of rental housing. More than 200 communities currently have some form of rent controls. Virtually all are located on the East and West coasts, where rental units make up an important part of the housing market.

Unfortunately, it is obvious that no amount of evidence demonstrating the inefficacy of rent controls -- and indeed their very substantial harm to the poor -- will convince local officials in these communities to abandon uneconomic and irresponsible rent control laws. NMHC therefore believes the time has come for federal intervention to prevent the continued impairment of the rental housing market. Preemption of all such local laws, at least to the extent they interfere with or impair federal housing policy, should be an essential part of any new housing policy.

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We thank you for this opportunity to comment on the form of a new federal housing policy. NMHC and its members look forward to the opportunity of working with the Subcommittee in future months to develop an effective and fair housing policy that satisfies the needs of both consumers and producers of housing.